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Meeting Before the Commission

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FEDERAL TRADE COMMISSION

I N D E X

WITNESS:

EXAMINATION

None.

E X H I B I T S

FOR IDENTIFICATION

Commission's:

None.

FEDERAL TRADE COMMISSION

In the Matter of:)
)
) Docket No.: P951201
 HEARINGS ON GLOBAL AND)
 INNOVATION-BASED COMPETITION)

Tuesday,
 November 7, 1995

Federal Trade Commission
 Sixth and Pennsylvania Avenues
 Room 432
 Washington, D.C. 20580

The above-entitled matter came on for hearing,
 pursuant to notice, at 9:40 a.m.

SPEAKERS:

ROBERT PITOFISKY
 Chairman, Federal Trade Commission

ROSCOE B. STAREK, III
 Commissioner, Federal Trade Commission

JANET D. STEIGER
 Commissioner, Federal Trade Commission

SUSAN S. DE SANTI
 Director, Policy Planning

DEBRA VALENTINE
 Deputy Director, Policy Planning

LAURA A. WILKINSON
 Deputy Assistant Director, Merger I Division
 Bureau of Competition

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SPEAKERS (Continued):

RICHARD SCOTT
President, HCA Healthcare Corp.

JAMES CUBBIN
Executive Director,
General Motors Health Care Initiatives

WILLIAM C. MacLEOD
Collier, Shannon, Rill & Scott
Grocery Manufacturers Association

PHILLIP PROGER
Jones, Day, Reavis & Pogue
Alliance for Managed Care

JOSEPH BRODLEY
Professor, Boston University

TERRY CALVANI
Pillsbury, Madison & Sutro

TIMOTHY MURIS
Professor, George Mason University

KEVIN O'CONNOR
Assistant Attorney General, Wisconsin
Chair, NAAG Multi-state Task Force

1 P R O C E E D I N G S

2 CHAIRMAN PITOFSKY: Good morning, everyone.

3 We continue our hearings. We're up to Day 10 of
4 hearings, and our emphasis last week and today will be on
5 the question of how to deal with efficiencies in the context
6 of competition policy.

7 This morning our emphasis will be, to some extent,
8 on efficiencies as they emerge, are relevant in the fast-
9 changing health care industry.

10 Our first speaker this morning is James Cubbin,
11 Executive Director of General Motors Health Care
12 Initiatives, a position he has held since March 1994. As
13 Executive Director, he is responsible for all activities
14 relating to GM's health care initiatives, legislative
15 analysis, and cost and quality improvements.

16 Mr. Cubbin joined GM in August 1963 and held a
17 series of engineering positions at the former Ternstedt
18 Division and Fisher Body Division. He joined the GM legal
19 staff in 1972 and practiced law in a variety of areas,
20 including environmental, product liability, marketing, and
21 trade regulation. He has also served as general counsel for
22 Saturn Corporation and the Buick-Olds-Cadillac Group.

23 Mr. Cubbin, welcome to these proceedings.

24 MR. CUBBIN: Thank you.

25 I would like to thank the Federal Trade Commission

1 for affording me the opportunity today to share with you
2 some of the General Motors' views regarding the role that
3 judicious antitrust enforcement can play in achieving
4 greater efficiencies in the delivery of health care
5 services.

6 General Motors has a profound interest in health
7 care and its reform. As well as being the nation's largest
8 industrial corporation, we are the largest single private
9 payer for health care services in the world.

10 We currently provide health care coverage to over
11 1.6 million employees, retirees, and to families throughout
12 the United States. In 1994, our U.S. health care bill was
13 \$5.4 billion. On a per vehicle basis that amounts to
14 approximately \$1200 for every car or truck we built, more
15 than we spent for steel.

16 We are also vitally concerned with improving the
17 health status of our work force. Our employee population is
18 older than is typical for the United States manufacturers as
19 a whole, and maintaining their health is a crucial element
20 in our drive to improve productivity.

21 When we look at the nation's health care system
22 today, we see many similarities to our own business just a
23 few years ago. In the early '80s, GM was not sufficiently
24 innovative or flexible in driving improvements to our
25 systems in order to bring costs down while better meeting

1 our customers' needs. As a result, we lost market share and
2 our profits suffered.

3 Our experience has taught us that meeting customer
4 needs must come first and foremost, and the same principle
5 holds true for health care. Better meeting health care
6 customer needs while holding costs will require innovation
7 and different ways of doing business.

8 Wise application of the antitrust laws has been
9 and can continue to be a force that promotes the sort of
10 innovation that can improve customer access to necessary
11 health care services while containing costs.

12 We are concerned, however, that antitrust issues,
13 whether real or imagined, could stifle valuable
14 experimentation in how health care services are planned for
15 and provided at the community level.

16 We believe that health care reform is moving to
17 the local level and that we can best contribute to improving
18 efficiency and quality by becoming an active player in
19 planning the evolution of community health delivery systems.

20 In doing so, however, we need the freedom under
21 the antitrust laws to work jointly with providers, insurers,
22 other payers, and citizens' representatives to explore more
23 efficient means of delivering care and better meeting the
24 community needs.

25 We also need to have a system that emerges from

1 these community-wide discussions evaluated under a rule of
2 reason analysis that takes into account some of the key
3 problems in applying conventional economic analysis to
4 health care markets.

5 As I noted, increasing efficiency in the health
6 care sector, while at the same time meeting customer needs,
7 will require innovation and experimentation. To date,
8 antitrust enforcement has largely been a force to promote
9 such innovation.

10 For example, the antitrust enforcement agencies,
11 by placing a check on the power of incumbent entities to
12 control access to key services, have proved a powerful
13 weapon in speeding the acceptance of managed care plans as
14 an alternative to additional fee-for-service medicine. But
15 too rigid an application of the antitrust laws could stifle
16 further innovation.

17 The fundamental problem in analyzing health care
18 markets under the antitrust laws, we believe, lies in the
19 definition of "output." I understand from our economists
20 and antitrust lawyers that typically the first question in
21 determining whether a particular practice or form of
22 organization enhances consumer welfare is whether or not it
23 enhances output.

24 The problem with properly applying this criterion
25 in health care markets is that the output that consumers

1 want out of the health care system is better health.

2 While the statistics that are generally used
3 measure numbers of procedures, hospital stays, doctor visits
4 and the like, these statistics measure inputs, not output, a
5 distinction missing from the conventional antitrust analysis
6 I've read concerning health care markets.

7 This mode of analysis can ignore efficiency gains
8 because it makes no distinction between medically beneficial
9 services -- which improve health outcomes and, hence, are
10 output enhancing -- and medically questionable services
11 which represent inefficiencies and have a neutral or, more
12 often, negative effect on outcomes.

13 As an example of how this distinction applies in
14 the real world, I would like to call your attention to a
15 study published last October in the New England Journal of
16 Medicine looking at hospital readmission rates in Boston and
17 New Haven, two cities with similar demographics but which
18 differ significantly in the number of resident-occupied
19 hospital beds per capita.

20 The researchers looked at matched cohorts of
21 Medicare patients initially admitted for one of five
22 potentially life-threatening conditions and then compared
23 how often the patients were readmitted in the following 35
24 months.

25 Patients in Boston were 1.64 times as likely to be

1 readmitted to the hospital as were patients in New Haven,
2 roughly proportional to the added per capita availability of
3 beds.

4 Yet mortality rates across the two cities and
5 across particular hospitals did not vary systematically with
6 readmission rates. If outcomes in Boston were no better
7 than in New Haven, despite 64 percent more readmissions, can
8 these readmissions really be classified as enhanced output?
9 In our view, they are better characterized as examples of
10 inefficiencies in the system.

11 Our experience as a payer causes us to believe
12 that the health care system can achieve greater efficiencies
13 while simultaneously enhancing the provision of medically
14 beneficial services.

15 One of the clearest examples to us is the
16 remarkable success that community-based health care planning
17 has achieved in Rochester, New York.

18 There are many features of the system in Rochester
19 which are analyzed and discussed in the 1993 General
20 Accounting Office report. We feel the most important relate
21 to community involvement in overall capacity planning and
22 the rationalization of the provision of specialized
23 hospital-based medical services.

24 Our experience in Rochester has been highly
25 satisfactory for both GM and for those who obtain their

1 health care coverage through us. Our health care costs in
2 Rochester are substantially lower than they are in any of
3 our top nine GM cities.

4 For example, on an age-adjusted basis, our cost
5 per member last year for one of our highest cost
6 communities, which is Anderson, Indiana, was 50 percent
7 higher than in Rochester.

8 If we could achieve the type of cost savings
9 achieved in Rochester in all our major employment areas,
10 that is the nine top cities, GM alone could reduce its
11 annual health care bill by almost \$500 million.

12 Such cost savings need not come at the cost of
13 lower quality care. In fact, they should not come at the
14 cost of lower quality care. By one important measure we
15 regularly track, the rate of inpatient complications per
16 non-Medicare claim, Rochester outperforms any of our top
17 nine communities.

18 Our experience is typical for companies operating
19 in Rochester. The GAO report, for example, shows that
20 Eastman Kodak's health care cost in Rochester averages more
21 than \$900 less per employee than elsewhere in the United
22 States.

23 With lower health care costs come lower insurance
24 premiums, making health insurance more accessible to
25 individuals and small employers; and Rochester has a far

1 lower rate of uninsured residents than does the rest of the
2 U.S.

3 With lower costs and better access, Rochester's
4 residents express a higher level of satisfaction with their
5 health care system than U.S. residents on average.

6 We believe that some of the elements that have
7 helped to reduce costs and improve access in Rochester can
8 be replicated elsewhere.

9 Perhaps the largest gains are possible through
10 achieving greater efficiencies in the provision of the
11 costly specialized or tertiary care services.

12 In Rochester, there is virtually no duplication
13 across hospitals in the provision of such services where
14 costly high-tech equipment or highly specialized human
15 skills are required, duplicative provision of services at
16 less than efficient scale can result in unnecessarily high
17 costs. It can also result in poor patient outcomes.

18 Our experience with heart surgery in some of our
19 communities, for example, shows that programs operating on
20 an adequate scale have significantly lower complications and
21 lower mortality rates than do small marginal programs.

22 These considerations, of course, are already
23 recognized in the FTC/Department of Justice Policy
24 Statements on joint ventures for high technology equipment
25 and for specialized procedures.

1 More generally, there are potential efficiencies
2 to be gained from capacity planning.

3 The economic forces shaping decisions in the
4 absence of planning are often not subject to much market
5 discipline. Indeed, the health care market is very
6 different in our view from other consumer goods and services
7 markets. Health care consumers have little, if any, quality
8 or cost information readily available to them.

9 Competition among facilities to provide expanded
10 services often takes place in an environment in which
11 generous insurance reimbursement policies on capital costs
12 largely insulate hospitals from downside risks.

13 In addition, while for-profit firms may be
14 reluctant to enter into or remain in unprofitable lines of
15 business, non-profit institutions may choose to do so
16 indefinitely provided that revenues elsewhere in the
17 institution are sufficient to offset the ongoing losses.

18 Without planning, communities often end up with
19 capacity for some medical services in excess of reasonable
20 community needs. If that capacity goes unused, it
21 constitutes a clear example of inefficiency. If it is used,
22 but in ways that do not improve patient outcomes, it creates
23 even greater inefficiencies.

24 While these inefficiencies are especially acute
25 when the excess capacity occurs in tertiary care facilities,

1 they can also be found in other parts of the health care
2 system as well.

3 We believe the most effective path to real health
4 care system reform is through consumers and payers becoming
5 more knowledgeable about the quality and cost of services
6 provided in their communities and then using that knowledge
7 to participate actively in re-engineering their local
8 delivery systems.

9 GM and our UAW partners have begun a large scale
10 test of this approach by undertaking initiatives to explore
11 the gains that might be achieved from community-based
12 planning in two of our highest cost GM communities.

13 We are now in the midst of gathering necessary
14 background data for Flint, Michigan, and Anderson, Indiana.
15 We have recently been joined in this endeavor by HCFA, the
16 Health Care Financing Administration.

17 The consultants working with us in Flint -- Lou
18 and VHI -- and in Anderson are preparing detailed community
19 assessments. Their work plan requires them to produce three
20 separate types of evaluations. The first is a health
21 assessment. It is designed to provide both a general gauge
22 for judging whether the health care delivery and public
23 health systems are meeting community needs in a context for
24 more in-depth analysis for the delivery system's
25 effectiveness.

1 From public sources and GM enrollment data, the
2 consultants plan to answer these questions pertaining to the
3 demographic and overall health profile of the target
4 communities.

5 Special attention will be paid to the health
6 status of mothers and children, to the special needs of
7 vulnerable populations, and to the prevalence in the
8 community of high-risk behaviors on the one hand and to the
9 prevalence of health promotion and disease prevention
10 behavior on the other.

11 The health assessment will compare the health
12 status of the target communities for the national and state
13 norms as well as to Healthy People 2000 Goals developed by a
14 broad consensus processed under the sponsorship of the
15 Department of Health and Human Services.

16 The second stage of the evaluation is the resource
17 assessment. It serves to identify available resources in
18 the community and to estimate service capacity levels,
19 assess health service needs, and from these, identify areas
20 of resource imbalance.

21 The resource assessment is designed to address the
22 full continuum of health care services from an examination
23 of public health resources through an exploration of
24 long-term care services. Although, the most detailed
25 analysis will be for in-patient services.

1 The resource portion of the assessment will rely
2 on a wide variety of sources including AMA and AHA
3 statistics while the community needs portion will be
4 developed using actual utilization data and best practice
5 benchmarks based on expert opinions and existing research.

6 The final stage of the community assessment is the
7 value assessment. Working from the base of information
8 developed in the other two stages, the value assessment is
9 designed to assess the effectiveness of the delivery system
10 in achieving positive health outcomes and determine if the
11 delivery system is operating in an economically efficient
12 manner.

13 While the resource assessment will focus on the
14 availability of services, the value assessment will focus on
15 the desirability of those services.

16 The value assessment will rely on patient level
17 transaction data and aggregate quality and cost data.

18 Benchmarks will be drawn from existing research,
19 published literature, expert opinion, and the best
20 performance systems and institutions.

21 It is just this sort of assessment that we believe
22 is necessary to evaluate fully the economic performance of a
23 community's health care system. Its emphasis on how well
24 the system helps achieve positive health outcomes rather
25 than how well it provides particular services reflects the

1 distinction I attempted to draw earlier between measuring
2 output rather than measuring inputs.

3 When added services do not contribute to improving
4 health outcomes, the assessment will properly label those
5 services as inefficiencies to be reduced rather than as
6 output to be encouraged.

7 The community assessment, when completed, will
8 serve as the basis for a fact book that can be used by
9 providers, insurers, other payers, and community leaders to
10 facilitate future discussions on improving the efficiency of
11 the health care delivery system in the target communities.

12 We hope to be able to engage all of these parties
13 in these discussions with the goal of rationalizing the
14 delivery of services in these communities.

15 If we are successful, we expect to cut costs,
16 improve outcomes, and enhance access by eliminating
17 inefficiency.

18 We believe that allowing such discussions to take
19 place among providers, consumers, and payers is in the
20 public interest and that they should not be the subject of
21 antitrust enforcement action.

22 How can judicious antitrust enforcement aid
23 experiments with community-based planning?

24 Let me first emphasize that we do not believe that
25 blanket exemptions for horizontal combinations in the

1 provision of health care services are warranted or
2 necessary.

3 However, in light of the difficulties that
4 conventional analysis has in measuring output and in
5 capturing all the efficiencies that might be achievable from
6 community-based planning, we think that the antitrust
7 authorities would be wise to allow some experimentation in
8 this area.

9 Provided that all the relevant stake holders --
10 that is providers, payers, and representatives of the
11 consuming public -- take an active part in the discussions,
12 we believe that the usual market power concerns about
13 horizontal agreements among providers or payers alone are
14 not relevant.

15 The antitrust authorities have apparently allowed
16 community-based planning to evolve naturally in Rochester,
17 New York. And we believe that other communities ought to
18 have the freedom to adopt similar arrangements if they prove
19 mutually satisfactory to all the relevant stake holders.

20 If even a fraction of the cost savings and
21 improved access that have taken place in Rochester can be
22 replicated elsewhere, then permitting such experimentation
23 will prove extremely beneficial.

24 Should it prove difficult to replicate the success
25 of the Rochester system, then the risks of permitting

1 experiments are small.

2 Since community-based planning does not require
3 widespread mergers and consolidations and since the system
4 depends on the cooperation of all stake holders, failed
5 experiments will undoubtedly expire naturally.

6 The test such arrangements ultimately will have to
7 satisfy to win antitrust approval needs to be established
8 under the rule of reason. One important consideration
9 should be whether the agreement represents input from all of
10 the relevant stake holders. Another will be to verify that
11 the plan contains credible measures to improve the
12 efficiency of the health care system.

13 The sorts of questions that might be asked
14 include:

15 Does the plan contain measures that might improve
16 the delivery of services currently provided?

17 Does the plan expand the output of medically
18 useful services previously under-supplied to the community
19 by improving overall access or meeting specific unaddressed
20 community needs?

21 And is there reasonable expectation that the plan
22 will enhance outcomes?

23 In conclusion, while the antitrust laws have, to
24 date, been an overwhelmingly positive force in opening the
25 U.S. health care system to new and more efficient ways of

1 doing business, there is a danger that too rigid an
2 interpretation of these laws could stifle valuable further
3 experiments.

4 The antitrust laws should not serve as a barrier
5 to achieving greater efficiency in the provision of health
6 care. We think that antitrust analysis that properly takes
7 a broad view of the efficiencies that might be achieved
8 through community-based planning can aid the continuous
9 evolution of the U.S. health care system for a more
10 efficient provision of needed services.

11 That concludes my prepared remarks. If you have
12 any questions, I'll try to answer them.

13 CHAIRMAN PITOFSKY: Well, thank you. That's a
14 remarkable view of these issues from what, I guess, must be
15 America's leading purchasers of health care service, if not
16 the leading purchaser.

17 MR. CUBBIN: Well, \$5.4 billion, I think, probably
18 outstrips most others.

19 CHAIRMAN PITOFSKY: It's a big chunk.

20 Let me follow up on your proposal about community
21 involvement, community assessment.

22 You did go out of your way to say that, on
23 balance, antitrust has been a useful force in keeping the
24 opportunities for new forms of health service and cost
25 containment in play.

1 Have you seen any situation -- I wouldn't think
2 that antitrust would be concerned about community
3 involvement designed to achieve efficiencies.

4 Have you seen situations where, either because --
5 where people backed away from the kind of community
6 involvement that you're suggesting, either because they
7 thought the law wouldn't permit it or they thought the law
8 was so unclear that it was dangerous to engage in it?

9 MR. CUBBIN: We have situations where that conduct
10 has occurred, at least the providers have indicated that
11 they were concerned about antitrust issues or confused.

12 It may be just an excuse to avoid the discussions
13 that are necessary; and we are trying to do everything we
14 can to encourage discussions that will be productive,
15 including, you know, offering to have antitrust lawyers that
16 have health care backgrounds available at those discussions,
17 inviting government to be involved. As I mentioned, we got
18 the Health Care Financing Authority and HHS.

19 We would welcome the FTC involvement in our
20 community assessment plans.

21 CHAIRMAN PITOFSKY: Commissioner?

22 COMMISSIONER STEIGER: May I ask, and you may not
23 know, would the Joint Policy enforcement statements, which
24 Justice and this agency have issued together, there has been
25 an offer for advisories by either of the agencies within 90

1 days on questions that may involve the policy statements,
2 area of concern and within 120 days on any health-related
3 question that the community might have as they move forward
4 in this rapidly changing world?

5 Do you know any instances where concern about
6 antitrust has been expressed whether they have sought
7 advisory opinions from either of the agencies?

8 I'm anxious to know whether this is being fully
9 used.

10 MR. CUBBIN: Right. I don't think so. The two
11 situations I'm thinking of, I don't think there was an
12 advisory sought.

13 I think there's -- again, it depends on whether or
14 not the concern is real or imagined or is just being used as
15 an excuse.

16 I've heard expressed concern that even though the
17 advisory is available that there's a potential for maybe too
18 rigid an application; and, in fact, maybe we don't want to
19 ask the question because we don't like the answer.

20 COMMISSIONER STAREK: If I heard you correctly, I
21 think you said that in the community-based systems that you
22 were describing, using Rochester as an example, that
23 enforcers should not be concerned about market power, that
24 the traditional concerns about market power in these
25 situations are not relevant.

1 I wonder if you could -- first, if I heard you
2 correctly? And, secondly, if I did or didn't, would you
3 tell me what you think about that?

4 MR. CUBBIN: Well, I think that was a little
5 broader than my statement. I think in community-based
6 planning when all the stake holders are involved --
7 including representatives of consumers, local government, et
8 cetera -- then concerns about market power may not be
9 relevant.

10 But I wouldn't say, in a broad context, we'd never
11 worry about concentration or market power.

12 COMMISSIONER STAREK: Why is that the case, then?

13 I mean, I don't understand how the fact that
14 communities are involved in it, then the market shouldn't be
15 something to be concerned about.

16 MR. CUBBIN: If, in fact, the community plan is
17 based on the best interest of all of the stake holders, if
18 it's consensus process that results in efficiencies and
19 quality improvements for the consumers, then I'm not really
20 too worried about one stake holder getting advantage. And
21 that's what you're talking about with market power.

22 I don't think that the providers would have that
23 much power in those kinds of circumstances, especially with
24 big payers involved like General Motors and Kodak and
25 others. We can always, I think, go outside the system and

1 bring in new players if the existing players aren't playing
2 the game.

3 CHAIRMAN PITOFISKY: I think that would be true
4 when you have sophisticated companies like your own --

5 MR. CUBBIN: Oh, I agree --

6 CHAIRMAN PITOFISKY: -- who are in the process, but
7 let me press you a little bit.

8 Suppose you have complete community involvement in
9 a community in which there's a wide distribution of
10 mid-sized businesses and suppose the proposal is that there
11 are three hospitals in -- four hospitals in town and the
12 group decides that we're better off with two, four to two.

13 Are you saying that antitrust authorities looking
14 at that hospital merger should defer to the community's
15 joint decision that two hospitals are better than four and
16 not apply the antitrust laws?

17 MR. CUBBIN: Not necessarily. I think you've got
18 to look at the facts; you've got to look at the expectations
19 for efficiencies. Are they real or imagined? The depth of
20 analysis.

21 I don't think that that kind of community-based
22 reform, necessarily, is perfect in every community. I think
23 what we've got to do here is allow for the opportunity of
24 experimentation, some flexibility, and always be focusing on
25 the consumers and whether or not the consumers' interest

1 really are being served by the activity.

2 CHAIRMAN PITOFSKY: And perhaps give some weight
3 to what the community tells us --

4 MR. CUBBIN: Right.

5 CHAIRMAN PITOFSKY: -- who are close to the
6 situation about what they think of efficiencies on the one
7 hand and anti-competitive effects on the other.

8 MR. CUBBIN: Exactly.

9 CHAIRMAN PITOFSKY: Susan?
10 Debra?

11 Well, thank you very much.

12 MR. CUBBIN: You're welcome.

13 As I mentioned, I will have copies of my statement
14 available. We didn't have it yet this morning, but I'll
15 submit that.

16 CHAIRMAN PITOFSKY: Good.

17 Our second participant this morning is Richard
18 Scott, President and Chief Executive Officer of Columbia/HCA
19 Healthcare Corporation, which I believe is now the largest
20 hospital corporation in the United States.

21 Mr. Scott formed Columbia in 1987, in Fort Worth,
22 Texas. Before founding that organization, he specialized in
23 health care mergers and acquisitions in his Texas law
24 practice.

25 Mr. Scott is a member of the Healthcare Leadership

1 Council, the Business Roundtable, and the Business Council,
2 and serves as a Director of Banc One Corporation. He was
3 recently recognized as a Silver Award winner for CEO of the
4 year by Financial World Magazine and cited as one of the top
5 25 performers in 1995 in U.S. News & World Report.

6 Mr. Scott, it's a great pleasure to welcome you to
7 these proceedings.

8 MR. SCOTT: Well, thanks for the invitation.

9 First, I apologize for being late. I thought it
10 started at 10:00, and we had great weather coming in from
11 National. I especially like not being able to see and then
12 the last turn so we don't go over the White House. We don't
13 do that in many other cities.

14 Chairman Pitofsky, Commissioners, thank you for
15 the opportunity to participate in these important hearings.
16 It is my hope that the actions resulting from these
17 deliberations will ultimately contribute to the health and
18 well being of our nation's citizens who turn to those
19 providing health care in often their greatest times of need.

20 Providing the best possible care to our patients
21 is what drives Columbia; and although these hearings deal
22 with complex and often esoteric economic theory, in the
23 final analysis it is the impact on our ability to provide
24 care to patients which formulates our perspective on these
25 issues.

1 The issues at hand are, one, how competition
2 really works in today's health care industry; two, when
3 government intervention should be used to protect that
4 competition; and, three, what impact government intervention
5 has on the health care industry's ability to continue to
6 provide excellent patient care at affordable prices.

7 The past decade has seen dramatic changes with our
8 nation's health care delivery system. The fact is that
9 these changes have been driven by the competitive forces at
10 work in the marketplace. Competition has never been
11 greater. Large employers and other purchasers of health
12 care are contracting for health care services on a large
13 scale, in some markets being able to relocate 50 percent or
14 more of a hospital's patients to another provider in less
15 than one week.

16 According to a Peat Marwick study cited in the
17 October 25, 1995, edition of the Washington Post, the
18 percentage of workers in managed care has risen from 29
19 percent in 1988 to 70 percent in 1995, with a dramatic
20 reduction in the rate of increase in employers' spending on
21 health care.

22 The nation's largest purchaser of health care, the
23 federal government, is proposing massive reductions in
24 Medicare and Medicaid. It is inevitable that, as part of
25 these reductions, most Medicare/Medicaid beneficiaries will

1 participate in a managed care program.

2 As a result of proposed Medicare and Medicaid
3 changes, there will be increased cost pressure on a
4 reimbursement system in which hospitals are already losing
5 money on many procedures.

6 For example, there are heart and circulatory
7 disorders for which hospitals lose almost \$1400 per case.
8 On the state level, Medicaid rates are being reduced
9 dramatically. In West Virginia, some non-emergency visits
10 by Medicaid beneficiaries to hospital emergency rooms are
11 being reimbursed at the rate of \$8 per visit. Other states
12 are proposing substantial reductions.

13 Combine these significant reductions in health
14 care costs with the highly capital-intensive nature of the
15 business and you have an industry that is under intense
16 pressure to increase efficiency and control costs while
17 maintaining the highest quality.

18 These pressures are creating the need for rapid
19 consolidation of the industry and the formation of
20 innovative partnerships and alliances.

21 Today, more than 35 percent of the nation's
22 hospital beds are empty. Of the more than 910,000 hospital
23 beds in the U.S., nearly 330,000 are empty. Occupancy rates
24 on average are at their lowest rates in decades.

25 In a number of states, 40 percent or more of the

1 hospital beds are empty. The cost and overhead of
2 maintaining this overcapacity are high and add to the health
3 care cost to consumers.

4 A typical consolidation of two facilities can save
5 4 to \$5 million dollars annually. Cost effectiveness is not
6 the only benefit derived from appropriate consolidations.
7 Eliminating redundant services results in an increase in the
8 number of times a specified medical procedure or service is
9 performed at a facility. This improves quality as the best
10 practices are developed due to the increased performance of
11 the procedure of service.

12 Of the approximate 5300 hospitals in the United
13 States, about 4600, or 86 percent, are tax-exempt
14 facilities. Tax-exempt hospitals generally have no
15 obligation to pay federal, state, or local taxes; nor do
16 they have an obligation to provide care to those who cannot
17 pay.

18 All hospitals provide care on an emergency basis
19 to those who cannot pay. The remaining approximately 700
20 hospitals are tax-paying, generally owned by publicly owned
21 companies, like Columbia.

22 Of the 5300 hospitals in the United States,
23 Columbia owns approximately 6 percent. Columbia was founded
24 in 1987 after a series of mergers and acquisitions which
25 included: Basic American Medical in 1992; Galen Health Care

1 in 1993; Hospital Corporation of America and Medical Care
2 America 1994; and Health Trust in 1995. We now operate more
3 than 330 hospitals, more than 100 surgery centers and a
4 number of other health care businesses in 36 states and two
5 foreign countries.

6 Columbia pays more than \$1 billion annually in
7 taxes, provides \$1 billion annually in uncompensated care,
8 and contributes almost \$2 billion to community foundations.

9 In many rural areas where Columbia is the only
10 hospital provider, physicians affiliated with our hospital
11 and Columbia provide all of the charity care.

12 Last week an article appeared in the Wall Street
13 Journal about the \$80 million foundation which was created
14 in Dickson, Tennessee, a town of less than 9,000 people.
15 The foundation was created when Columbia purchased Good Luck
16 Hospital. All of the foundation funds will be used for
17 charitable and community causes including: parks,
18 educational opportunities, and social needs.

19 Similar foundations have been created when we
20 purchased hospitals in Miami and Winter Park, Florida;
21 Alexandria, Louisiana; Oklahoma City, Oklahoma; Wichita,
22 Kansas; Denver, Colorado; Cleveland and Canton, Ohio; and
23 Columbia, South Carolina.

24 Clinics for the poor, elderly, day-care centers,
25 teaching programs, research grants for new medical devices

1 and drugs, mammography centers for the poor are just a few
2 of the uses of these foundation funds.

3 Columbia was founded with a strong commitment to
4 the values of free markets in a competitive process. The
5 company was formed with the belief that we could provide a
6 full range of health care services. If we could provide a
7 full range of health care services over a broad geographic
8 area as needed by employers, insurance companies, and
9 individuals and provide better outcomes and higher patient
10 satisfaction, then we would be able to attract patients to
11 our facilities.

12 We recognize that the ability to create
13 comprehensive integrated networks of health care providers
14 would be the key to offering high quality care in the most
15 cost-effective way.

16 The vision of Columbia is to work with its
17 employees and physicians to build a company that is focused
18 on the well being of people, that is patient oriented, that
19 offers the most advanced technology and information systems,
20 that is financially sound, and that is synonymous with
21 quality, cost-effective health care.

22 Within that vision, the foundation of our
23 philosophy is offering an affordable price, producing a high
24 level of patient satisfaction, and having the best outcomes
25 in the country.

1 We have a strong track record of fulfilling this
2 vision. Ongoing Gallop Polls conducted at our facilities
3 indicate that 95 percent of the patients we serve were
4 either satisfied or very satisfied with the care and the
5 service they receive at Columbia facilities.

6 Each quarter, more than 40,000 patients are
7 surveyed by Gallop concerning issues such as overall nursing
8 care, concerns shown by staff, cleanliness, staff
9 communication, and a number of other issues pertinent to
10 patient satisfaction.

11 For most consumers, the purchase of specific
12 health care procedures is a one-time or first-time event.
13 They have little experience in terms of making intelligent
14 choices concerning which provider offers the best services.

15 Columbia is leading the industry in the
16 development of outcome measurements whereby consumers can
17 rate and compare the results of specific procedures among
18 hospitals.

19 Columbia uses industry-accepted outcome measures
20 to assist the facilities in monitoring and improving the
21 quality and effectiveness of care.

22 These measures address quality from a multiple of
23 perspectives, including clinical, financial, customer
24 satisfaction, and patient health status and well being.

25 Columbia compares its results to national

1 benchmarks and peer facilities in an effort to promote and
2 transfer best practices throughout the country.

3 To date, Columbia's Miami Heart Institute has the
4 lowest mortality for open heart surgery in the entire
5 nation.

6 And seven of Columbia's Florida hospitals were
7 included in the list of the top 10 hospitals with the lowest
8 mortality rates in open heart surgery.

9 Within the context of all of our efforts, let me
10 say that Columbia holds a deep-seated belief in and respect
11 for the intent of antitrust laws.

12 Columbia does not want to deal with monopolies or
13 cartels in connection with any of its supply purchases or
14 purchasers of health care services.

15 We recognize the importance of well-reasoned
16 antitrust enforcement in protecting competition and
17 consumers.

18 As we are all aware, Columbia is no stranger to
19 this Commission. In the past two years, we believe we have
20 filed more Hart-Scott-Rodino pre-merger notifications than
21 any other single company.

22 The FTC has thoroughly scrutinized Columbia,
23 requiring us to supply more than 2,000 boxes of documents in
24 the last two years -- incurring the time and expense of
25 numerous attorneys and economists -- in order to justify our

1 competitive activities. We have been forced to divest 10
2 hospitals and one surgery center and undo one joint venture.

3 In other cases, your actions have inhibited others
4 from entering into negotiations with us that would have
5 benefitted the delivery of health care in certain markets.

6 Significant FTC resources and staffing levels have
7 been allocated to scrutinized Columbia and the health care
8 industry.

9 It will come as no surprise that from our
10 perspective, FTC efforts related to Columbia have, in
11 certain cases, resulted in actions that have entrenched the
12 dominant provider and prevented the increase of competition.

13 The mandated divestitures and undoing of joint
14 ventures have not only failed to improve competition in the
15 health care industry but have also, in some markets,
16 entrenched and strengthened larger competitors.

17 The rulings in some cases have caused a reduction
18 in the quality of care in certain communities by inhibiting
19 the development of cost-effective consolidations.

20 Let me give you some examples.

21 In the Augusta, Georgia, area there are eight
22 hospitals. The 662-bed University Hospital is by far the
23 most dominant in the market. Because of its size and
24 resources, the tax-exempt University Center has built a
25 network of out-patient centers, rural health centers, and

1 ambulatory surgery centers, which has enabled it to capture
2 close to 50 percent of the patients in the Augusta market.

3 Because University Hospital offers a full range of
4 services, including heart, and because many of its
5 competitors are not allowed to add services such as heart
6 services due to state certificate of need laws, University
7 can and does refuse to contract with certain insurance
8 companies and makes exclusion of other providers a condition
9 when it elects to contract with an insurance company.

10 Columbia operates Augusta Regional Medical Center,
11 which, because of Georgia's certificate of need laws, cannot
12 offer certain services such as heart services, angioplasty,
13 and lithotripsy.

14 Aiken Regional Medical Center was part of Hospital
15 Corporation of America, a company we acquired in February
16 1994. Aiken Medical Center is in South Carolina across the
17 Savannah River and approximately 35 miles from Augusta
18 Regional.

19 It was our intent that through the combined
20 resources of the two facilities and the belief that Aiken
21 would be allowed to add heart services, we would begin a
22 heart program. Our ability to offer these programs would
23 have increased the competition in the Augusta area for these
24 services and lowered the cost of health care to the
25 community.

1 We believed that Augusta Regional and Aiken
2 Regional combined would have provided an opportunity to
3 compete against University Hospital. Yet the FTC refused to
4 let the transaction transpire.

5 The result is that the dominant player in the
6 market, University Center Medical Center, remains secure in
7 its position without the need to renegotiate prices. Thus,
8 prices for heart services, incidentally, are almost three
9 times higher than in nearby Atlanta.

10 Not one doctor on Augusta Regional's medical staff
11 was on Aiken's medical staff, and not one doctor on Aiken's
12 staff was on Augusta's.

13 The FTC's actions in Augusta have clearly
14 entrenched University Hospital in this area.

15 Next, in Anchorage, Alaska, Alaska Surgery Center
16 was part of our acquisition of Medical America. Our intent
17 to utilize the facility to complement our operations at
18 Alaska Regional Hospital was denied by the FTC on the basis
19 that once the acquisition was complete we would have had 12
20 of the 27 surgery suites located in the City of Anchorage.

21 The purpose of the acquisition was to increase
22 competition with Providence, the market's dominant player
23 with 65 percent market share.

24 Part of that competition would have been lower
25 prices. Part of that competition would have been to offer

1 options to insurance companies like Aetna and Blue Cross
2 that now have contracts with Providence on a basis that
3 Providence has all of the services.

4 The FTC ruling in Anchorage ensures that
5 Providence Hospital will continue its dominance, thus
6 hindering competition. Providence has 15 operating rooms
7 combined. Anchorage Regional and Alaska Surgery Center
8 would have had only 12.

9 As in Augusta, the ruling has produced the very
10 effect it was intended to prevent: entrenching a dominant
11 player within the marketplace.

12 In our efforts to sell the Surgery Center, we
13 negotiated a provision with a potential buyer of the Surgery
14 Center preventing the buyer from, in the future, selling the
15 Surgery Center to Providence, the dominant hospital in the
16 market.

17 The FTC would not allow us to include that
18 provision in the sale. Once sold -- and we were having a
19 very difficult time selling the Surgery Center -- the
20 Surgery Center will be allowed, then, to team up with
21 Providence, again entrenching the dominant player in the
22 market.

23 Another example of FTC intervention which produced
24 negative impact on a community is in the Orlando area.

25 As a result of Columbia's merger with Galen and --

1 first off, there's the maps in the back of the presentation.

2 As a result of Columbia's merger with Galen, we
3 would have owned two hospitals in Kissimmee, Florida, next
4 to Disney World, and clearly part of the Orlando market.
5 Practically every physician on the medical staffs of the
6 Kissimmee hospitals was on the medical staff of the Orlando
7 hospitals.

8 We would have been able either to consolidate
9 services on one of the Kissimmee campuses or direct specific
10 services to either campus, generating a conservatively
11 estimated savings of \$20 million.

12 In the last seven years, we, as a company, have
13 consolidated 20 hospitals nationwide with other hospitals in
14 our markets. In either case, this would have significantly
15 reduced costs and improved care.

16 The FTC forced us to divest one of those
17 facilities to Florida Hospital, a tax-exempt hospital system
18 that already had six Orlando hospitals -- and you can see on
19 the map, it's sort of the purple color -- controlling more
20 than 35 percent of the Orlando market.

21 As a result of that divestiture, the Kissimmee
22 community is serviced by two half empty hospitals.
23 Duplicative services have been added in the market that were
24 not needed.

25 A major flaw in the FTC decisionmaking process was

1 its failure to analyze the Orlando market as a whole,
2 rather, looking at adjacent community as stand alone areas
3 with a majority of patients in the area directed to medical
4 services through managed care contracts.

5 The market dynamics are such that patient
6 populations across a multiple county area must be looked at
7 as an integrated whole, not separate populations served in
8 separate communities.

9 When looked at in the reality of managed care, it
10 becomes apparent that Columbia would not have been a
11 monopoly in Kissimmee at all.

12 As a result of the Columbia Health Trust merger,
13 there is a similar scenario in the northern part of Orlando
14 where one party in a 50/50 joint venture must divest.

15 Orlando Regional Hospital, ORHS, a second hospital
16 system in the area, which, without this facility, already
17 owns four hospitals and already controls nearly 35 percent
18 of the Orlando market now controls this facility.

19 It's located where the question mark is. So what
20 you can see is Florida Hospital covers the entire market
21 area. Orlando Regional is sort of in the center. But if
22 we're forced to divest -- which we're being forced to --
23 then they will again have a presence in the north.

24 Because ORHS knows there is no other buyer for our
25 50 percent ownership interest in the joint venture and we

1 are forced to insure one party to divest, they have offered
2 to purchase our 50 percent interest for \$12 million dollars,
3 even though they have turned down our offer to purchase
4 their 50 percent interest for \$30 million dollars.

5 Combined, Florida Hospital and ORHS, that operate
6 hospitals, who were forced to -- or are being forced to
7 divest -- now control more than 70 percent of the Orlando
8 market and are seeking alignment strategies that establish
9 joint marketing and service opportunities.

10 One of ORHS's stated goals for 1996 is to, quote:
11 "Complete agreement to complete at least one shared or joint
12 venture community project with the Florida Hospital system,"
13 unquote.

14 Once again, rather than opening up competition,
15 the FTC decision squashed it. The FTC decisions have
16 clearly entrenched the two largest hospital systems in
17 Orlando.

18 This is a map of the state of Utah. As you can
19 see on this map, there's a tax-exempt group called
20 Inter-Mountain Health Care. They have 19 hospitals in the
21 state.

22 We're -- and they're the orange. We're, I guess
23 the diamond. It looks like green. And we're allowed to
24 keep seven hospitals.

25 Probably the FTC decision I understand the least

1 is the decision to cause the divestiture of three Utah
2 hospitals after the merger of Columbia with Health Trust.

3 Currently, the former Health Trust Hospitals are
4 being held in a separate company with which I cannot
5 communicate related to strategy and operations.

6 And that was caused by the Federal Trade
7 Commission's decision.

8 During this down time, Inter-Mountain Health Care,
9 IHC, the dominant player in the market, is using this delay
10 to its full advantage to further entrench its market
11 position, utilizing media blitzes of unparalleled
12 proportions.

13 Based on 1994 admission data, Inter-Mountain, a
14 Utah hospital managed care system, attracted 54 percent of
15 in-patient admissions and 57 percent of out-patient visits
16 statewide.

17 If Columbia had been able to retain all the
18 hospitals Health Trust owned, it would have attracted only
19 26 percent of the in-patient admissions and 21 percent of
20 the out-patient visits statewide.

21 We are being left with 18 percent of the
22 in-patient admissions and 21 percent of the out-patient
23 visits, because the FTC has ordered us to divest three Utah
24 hospitals.

25 Inter-Mountain will control 45 percent or greater

1 of Salt Lake City area admissions compared to 19 percent for
2 Columbia; 85 percent of Utah County admissions, compared to
3 15 percent for Columbia; 60 percent of Northern Utah
4 admissions compared to 30 percent for Columbia; and 53
5 percent of statewide rural admissions compared to 18 percent
6 for Columbia.

7 In a recent newsletter in the market, IHC stated,
8 quote: "Sure, Inter-Mountain has had a dominance in the
9 marketplace," unquote, quote: "IHC has come away with its
10 reserves." "So what is the benefit to the patients and to
11 the community of the Columbia HCA intrusion? Probably a
12 little lower rates."

13 And, finally: "I don't think Columbia appreciates
14 the depth of support for its opponent, the political and
15 financial network of IHC and the support of the LDS church.
16 IHC will be standing when all is done," unquote.

17 Once again, the actions of the FTC not only
18 inhibited additional competitive forces to be interjected
19 into the market in question but also further entrenched the
20 position of the dominant player in the area.

21 Neither the health care industry nor the
22 communities served have benefitted from these actions. The
23 perception of the health care industry in each of these
24 examples cited is that it was the case that the FTC demanded
25 a pound of flesh in a large transaction where, one, the

1 divestiture would not have occurred if the acquisition had
2 been a single transaction; and, two, the FTC took actions
3 irrespective of the impact on the communities and patients
4 involved.

5 These actions have merely added to Columbia's cost
6 of doing business and prevented savings efficiencies that
7 could have benefitted consumers in these areas in these
8 facilities.

9 The FTC continues to prescribe that individual
10 markets must have certain numbers of hospital providers.
11 The truth is, most markets can support three delivery
12 systems at best, with many requiring and only being able to
13 support two competitive systems. In some markets, one
14 hospital is all that a community can support.

15 It makes no sense, either from the standpoint of
16 efficiency, cost, or quality to have competing facilities
17 standing across the street from each other each 40 percent
18 full and both incurring the overhead necessary to remain
19 open, offering redundant services and staffing.

20 Requiring hospitals to operate in such
21 environments can only result in severe pressures on facility
22 cash flows which are operating in a very capital-intensive
23 business.

24 For example, at Columbia, 150 percent of our
25 annual net income is spent on new equipment and renovations

1 at our existing facility.

2 As in any business, when there are cash flow
3 problems, there are usually reductions in variable costs and
4 capital expenditures.

5 In health care when hospitals have significantly
6 reduced reimbursements, are prevented from reducing costs
7 through consolidation, there is no other choice than to
8 eliminate the purchase of new technologies and limit or
9 eliminate procedures on which the hospital loses money.

10 Often these cash flow constraints force staff
11 lay-offs, many times the best paid and the best trained.
12 These actions have a profound negative impact on patient
13 care. Like you, I would not want to take a child, spouse,
14 family member, or friend to a facility which could not offer
15 the latest technology and the best employees. And yet that
16 is what people are being forced to do in some cases where
17 consolidations are prohibited.

18 The cost and potential harm of government
19 interventions, including the unintended consequences,
20 suggest that antitrust enforcement policies must be based on
21 sound economic theory and supported by empirical evidence.

22 Moreover, the application of these policies or
23 those policies in any particular case should reflect the
24 true nature of competition in that industry.

25 Antitrust enforcement officials must attempt to

1 identify the forces that actually determine competition in
2 that industry and take them into account before and during
3 any antitrust review.

4 In our view, the federal Horizontal Merger
5 Guidelines utilize a model of competition that does not
6 correlate to the real world of health care. We asked the
7 distinguished economists of Economists Inc., many of whom
8 have served on the Federal Trade Commission and the
9 Antitrust Division, to review the concentration models
10 employed by the FTC to help us better understand, one, the
11 reasons for the specific concentration standards
12 incorporated in the guidelines; and, two, the relevance of
13 those standards to predicting the effective hospital mergers
14 on competition.

15 The results of their analysis appear in Appendix B
16 of my written testimony.

17 Very briefly, their findings indicate that: One,
18 the models on which the guidelines analysis have
19 differentiated products appear to be based not -- appears to
20 be based not -- do not provide a clear relationship between
21 concentration and market performance.

22 Next, there is no evidence of a critical
23 concentration level above which coordination becomes likely.
24 In fact, an FTC staff report could not find any relationship
25 between concentration and price. Yet, the guidelines

1 presume that a problem would exist.

2 And, three, the very nature of hospital operations
3 makes coordination almost impossible.

4 Hospitals compete along hundreds of discrete
5 services, and their customers are represented by powerful
6 bargaining organizations. Illegal coordination under these
7 conditions is virtually impossible.

8 Given the facts that studies have shown very
9 little relationship between concentration and competition in
10 the marketplace when it comes to health care and that
11 consolidation and innovation are absolutely critical
12 components for controlling health care costs and maintaining
13 quality, we would suggest the following:

14 One, that the FTC more formally recognize the
15 substantial efficiencies and benefits achieved through
16 hospital integration within the current economic conditions
17 in the marketplace and acknowledge the benefits to consumers
18 in terms of cost and quality.

19 Two, eliminate the use of the concentration
20 presumption in evaluating hospital mergers and in fact
21 presume that three or even two hospital systems in a
22 community will provide effective competition.

23 Three, that the potential for anti-competitive
24 effects be examined on the basis of the specifics of the
25 transaction at hand and the conditions that exist in that

1 particular geographic market. Examples that I cited in
2 Augusta, Anchorage, Orlando, and Utah are good illustrations
3 of why this is needed.

4 Four, that the investigative process be reformed
5 to make the discovery process less burdensome in light of
6 knowledge gained through a long history of hospital merger
7 investigations and that the review process for divestitures
8 be streamlined.

9 And, five, that the FTC take into account that
10 preventing consolidation could adversely impact the quality
11 of patient care.

12 In health care, the ability to be innovative and
13 react quickly to changing market conditions will be the keys
14 to both hospital survival and consumer well being.

15 Hospitals must be allowed the freedom to innovate,
16 consolidate, and form creative partnerships in order to meet
17 the dual demands of controlling price and providing high
18 quality care.

19 The Commission must recognize and communicate this
20 recognition that the factors that drive competitive
21 performance in the health care industry cannot be captured
22 by the static models of competition currently employed.

23 Having offered these solutions, let me emphasize
24 that they are really suggestions directed to the Commission
25 itself. Your staffs have been notable in their willingness

1 to work with us to minimize burdens within the limiting
2 parameters of what they consider your directives.

3 My suggestions, therefore, should not in any way
4 be considered as an adverse reflection on anyone on your
5 staffs; but in the spirit of these hearings, I do not want
6 to note -- I do want to note that some further changes need
7 to be made to reduce the cost and burden of antitrust
8 investigation.

9 In conclusion, we at Columbia believe that the
10 enforcement of federal antitrust laws, which the Supreme
11 Court has called the Magna Carta of our economic liberties,
12 is vital. Columbia supports vigorous enforcements. We also
13 applaud your efforts in these hearings to come to grips with
14 the realities of competition in varied and highly different
15 industry and service markets in order to determine which
16 government intervention is really required to ensure
17 competition.

18 We have done our best to describe the marketplace
19 in which we work, what conditions should exist to best serve
20 our patients, some real world examples of the effects of
21 unnecessary intervention, and changes that are needed in the
22 way government intervention is determined in hospital
23 situations.

24 We hope this testimony and accompanying appendixes
25 will add in your endeavors.

1 Thank you very much.

2 CHAIRMAN PITOFISKY: Well, thank you for extremely
3 candid and informed testimony on this question.

4 It's a little difficult to discuss those cases
5 that turn on relevant market definition. What I hear you
6 saying is that in Augusta, the Commission drew the market
7 too narrowly, in South Carolina too broadly. It's hard to
8 get at that. So let me ask -- let's talk about the policy
9 questions.

10 You say there's no evidence of a connection
11 between concentration and price; and you say we should drop
12 our presumptions based on concentration; and that three
13 hospitals or two are okay.

14 Do you mean that for cities like New York and
15 Washington and Chicago, that three hospitals are enough or
16 two and that there should be a presumption that mergers
17 leading to that kind of concentration is permissible?

18 MR. SCOTT: I think what you should expect in
19 cities like -- take Miami, Atlanta, Chicago -- I can't talk
20 about New York; we don't do business there -- Houston,
21 Dallas, I think what -- all you're going to be able to
22 support in those markets is a two- or three-hospital system,
23 probably in a bigger city like that, a three-hospital
24 delivery system. In some smaller cities, you'll end up
25 having a two-hospital delivery system. And then in small

1 towns, you can't afford to have more than one hospital.

2 If you look at the pressures you have in the
3 industry -- just think about, first off, reimbursement for a
4 second. We're close to the industry average. We have 50 --
5 about 53 percent of our revenues are Medicare and Medicaid.
6 42 percent Medicare, I think it is, and 13 percent Medicaid.
7 All those prices are set by the government.

8 We have about 6 percent bad debt. That doesn't
9 include uncompensated care. We have approximately,
10 depending on the quarter, 12 to 14 percent of our revenues
11 are sort of -- are charges, what we set the price at. The
12 rest are negotiations with companies like General Motors or
13 companies like United Health Care and things like that.

14 If you have three or two delivery systems, you
15 have competition and you have the ability to do the things
16 that we're doing: consolidate hospitals, which we have
17 done. We have closed 20 hospitals close to our other
18 hospitals. When you can do that, and instead of running 40
19 percent occupancy, run 80 percent occupancy, you can
20 dramatically reduce your costs and improve your quality.

21 You can -- which we're doing -- a significant
22 number of management consolidation in each of these markets
23 to reduce the highest paid people and layers of management,
24 basically, to reduce cost.

25 You can't do that if you keep, in a market, 42

1 separate hospitals open and operating all separately.

2 CHAIRMAN PITOFSKY: I guess, again, I'm referring
3 back to the some of the illustrations that you mentioned.

4 The common theme is that there is an entrenched
5 dominant hospital in a community. And let's assume it's a
6 community that can't support 10 hospitals or even 6. And
7 what you're saying is that antitrust makes a mistake in
8 allowing 2 or 3 of the smaller hospitals to get together and
9 combine in order to compete with the entrenched monop- --
10 dominant company, not a monopolist but a dominant company.

11 Now, we wouldn't listen to that argument if we
12 were talking about tooth paste or if we were talking about
13 oil or steel.

14 And I do hear one of the things that you're
15 saying, which is that hospital services are so heterogeneous
16 that even if there are two firms left, it's unlikely they're
17 going to get together and work out a decent conspiracy.

18 Are there other reasons besides hetero- --
19 incidentally, you know, supermarkets and department stores
20 have a wide range of heterogeneous products; but we wouldn't
21 let all the supermarkets in town merge down to two in a
22 medium-sized community.

23 What is it about health care that you think should
24 make the difference?

25 MR. SCOTT: Well, I think -- well, I mean --

1 unfortunately, I'll talk about examples. But let's take
2 Utah as an example.

3 You know, you sit there, somebody has over 50
4 percent market share. Okay? And you can use your best
5 efforts all you want to try to say, golly I'd like to have
6 even three competitors statewide. You're not going to get
7 it. It will cost probably \$500 to \$700 million in new
8 capital in an industry that doesn't need a lot of new
9 capital or a lot of new buildings. That's what it would
10 take to have each new player to have a statewide delivery
11 system to compete against Inter-Mountain.

12 You know, you can't solve all of the problems.
13 You go to places that have certificate of need laws. I
14 mean, take Georgia, I mean, right or wrong, whether we
15 should or shouldn't have certificate of need laws, there's
16 somebody entrenched that has all the services. If you want
17 competition, you should support a second player that gets
18 the position that they really can compete.

19 But what -- your actions are preventing that from
20 happening. You don't -- you've prevented a second player.
21 I mean, we're -- you take Utah, we're a weak player, much
22 weaker now. I mean, we have -- they have four hospitals in
23 Salt Lake City. We were allowed to keep one. I mean, we're
24 -- I mean, we can't go to people like United and get the
25 contracts. They have to deal with Inter-Mountain.

1 So, I mean that's -- I mean you -- I mean -- I
2 think if you can -- in a big enough market and there's
3 enough reimbursement that you can have three players, I
4 think that's great.

5 But if the markets -- you know, somebody already
6 has 50, 75 percent, I mean, you're not going to be -- you
7 can't force it to happen. And that's what you're trying to
8 do in my opinion.

9 CHAIRMAN PITOFISKY: Okay. So it's better to have
10 two powerful players because a third player is unlikely to
11 enter the market because --

12 MR. SCOTT: Right.

13 CHAIRMAN PITOFISKY: -- of certificate of need?

14 MR. SCOTT: If I was not in Utah today, it would
15 make no sense to go, you know, spend -- I guess it would
16 cost, for a statewide -- it would cost me, you know,
17 somewhere between \$500 million and a billion dollars to go
18 into that state of two million people. You know, I mean,
19 nobody would do that.

20 CHAIRMAN PITOFISKY: One last question. I don't
21 mean to dominate this. But all of the people in America --
22 this question has bothered me for a long time, and you're
23 probably in a better position to answer this than anyone
24 else I could possibly talk to.

25 Most of your acquisitions are really what we call

1 conglomerate acquisitions. You're not buying two hospitals
2 in Salt Lake City. You're coming into new territories where
3 you weren't competing previously.

4 And I've been curious. What -- and you've done
5 extremely well and the market appreciates what you've
6 accomplished. What are the efficiencies that you achieve by
7 having 300-some odd hospitals, including many in which you
8 are the only hospital in town?

9 How do you get those efficiencies?

10 MR. SCOTT: Well, let me talk about -- we have
11 some efficiencies from size, and then we have efficiencies
12 by having a lot of facilities in a saturated marketplace
13 having good geographic coverage.

14 So let me talk about -- let's take, a -- first, a
15 market. In that market, I can -- if I have two hospitals
16 that's across the street from each other that are, you know,
17 each running 40 percent occupancy, I can either direct
18 services between the two, but hopefully I can consolidate
19 them into one.

20 Let me give you examples.

21 Just to open up the doors, okay? of a 300-bed
22 hospital, it's a million to \$2 million dollars just in
23 utility costs. Just to keep it going every year, it's
24 500,000 to \$2 million in capital costs, just for new
25 equipment and technology. All right? And that's something

1 that might only be used three hours a day. And if I can
2 only attract, you know, get 40 percent occupancy, I mean,
3 it's just not very well used.

4 So, one, I can have one emergency room, one
5 radiology, one lab, if I just put two together. All right?
6 And that's -- I mean, one we did in Miami where we merged
7 Victoria which operated about 116 patients a day with Cedars
8 which operated about 260. I think our first year we
9 eliminated at least \$12 million of daily operating costs.

10 Next, we can take, where we have -- take Miami,
11 Fort Lauderdale, Palm Beach, we have 16 in-patient
12 facilities down there and a variety of surgery centers. We
13 can take and run a reference lab in one facility. We have a
14 big reference lab in Cedars Medical Center. And we do that
15 for the entire marketplace which helps us reduce our lab
16 costs.

17 We can -- we've done -- just in 1995, we've taken
18 and said we'll take one person and they'll be responsible
19 for two or three hospitals. And that's the highest paid
20 person there, the CEO of the hospital.

21 I mean, the reason I went on Banc One's board is
22 the banking industry is basically doing the same thing; and
23 I wanted to understand what they were doing.

24 We can share department heads. You take a
25 hospital's -- and, again, the highest cost is the management

1 positions; and so when we can share department heads among a
2 variety of hospitals, we can dramatically reduce the costs.

3 Next, you look at the marketing. When you have,
4 you know, 16 facilities -- you know, I think Miami to Palm
5 Beach would probably be 3-1/2 to 4 million people, my
6 marketing costs can be a lot less expensive if I market as a
7 group.

8 I can afford to employ a lot of people that our
9 individual hospital couldn't afford, such as we have a lady,
10 Carolyn Lipp, that all she does is focus on outcomes just
11 for that market. I couldn't afford somebody like that at
12 any one facility, and so I would have to go hire consultants
13 to do that. And they have to be there to have the biggest
14 -- they have to be in that marketplace to have the biggest
15 impact.

16 Now, some of the big -- probably the -- so -- and
17 those things add up. You know, 4 to \$5 million is what I
18 said in the presentation. It's more than that. By putting
19 things together, that's a conservative number.

20 Now, what can I do nationally?

21 I buy \$2.4 billion a year in medical supplies. By
22 committing more volume to companies like Marriott, where we
23 purchase all of our food, by committing to do business with
24 DuPont, Johnson & Johnson, Baxter, I've -- and when we've
25 compared our supply costs as compared to our competition,

1 which are bigger buying groups -- they are the tax-exempt
2 buying groups -- we save 15 to 35 percent. That's, for you
3 as a buyer of health care, 3 to 4 percent of what you're
4 charged, because the supply costs depend on the tertiary
5 services of the hospital's 12 to 20 percent.

6 I put in an information system that -- the cost
7 for me to put in that system -- and it's the best
8 information system in the country. It's got a real-time
9 medical record; so if you're a physician and you're sitting
10 at your house or at your office, as soon as the lab results
11 are done, you're flagged; your computer beeps; or,
12 eventually we're doing it with the pagers; and you get the
13 information.

14 We can put that in for one-third of what it costs
15 a stand-alone facility to put it in. Plus, for you as a
16 patient, when you end up in an emergency room, would you
17 rather that your medical record be there or be sitting at
18 some other hospital or some physician's office?

19 In our system, your medical record is on-line at
20 our facility at any one of our emergency rooms, any one of
21 our urgent care centers; your medical record is immediately
22 available as you walk in. So it dramatically reduces the
23 cost.

24 Then you have all the -- you know, the issues that
25 we have in our industry, you know, just the cost of tax,

1 reimbursement, legal, all those things we can share costs.
2 And -- but those -- the big dollars are -- is probably the
3 information systems and the supplies and then individual
4 market consolidating management teams and directing service.

5 I mean, I'll tell you, the dollars are
6 unbelievable, the size. Just by -- just -- because,
7 historically, this industry had nobody of size and they made
8 no commitments to vendors and so you got no discounts.

9 We went and we got all of our orthopedic surgeons
10 together, or a big group of them, and we said: What are the
11 two top orthopedic companies for hip implants? And we said:
12 We will try, okay, to commit more volume to them. You tell
13 us who the best two are, because we believe that we can
14 commit more volume to them we will get a better price.

15 Most hospitals lose money on hip replacements --
16 Medicare hip replacements. There had been no discounts,
17 basically, in the industry. We got 45 percent reduction.
18 Now, we still have to talk everybody into using it because
19 you can't dictate these things. But it's -- so it's a lot
20 of work. But I mean by committing volume, you really can
21 get significant reductions; and you can pick the best
22 products.

23 CHAIRMAN PITOFSKY: Thank you.

24 COMMISSIONER STEIGER: Very brief question,
25 Mr. Scott. In your extensive management experience, have

1 you found that some over-capacity in hospital beds is
2 necessary to handle peak usage?

3 And, if so, is this only a regional phenomenon due
4 to, say, population fluctuation?

5 MR. SCOTT: If you look at the numbers -- if you
6 go to places like Fort Meyers and Fort Lauderdale, you can
7 have a doubling in the number of patients between summer and
8 winter. Okay?

9 Now, that's the -- that would be more true the
10 more tertiary your services. So we have large -- where we
11 have large open heart programs in Florida, we could double
12 our services.

13 A lot of that is because we have a significant
14 number of Canadians who come to the United States for open
15 heart services.

16 If you look at the rest -- you know, where you
17 don't have a significant number of snow birds, the
18 difference would probably be in the 10 to 20 percent range
19 between winter and summer. That is slowly going away as
20 length of stays are coming down so dramatically and as
21 patients are leaving the hospital faster and going into home
22 health faster. But that would probably be a history, you
23 know, it would be 10 to 20 percent for a normal market.

24 CHAIRMAN PITOFISKY: Susan?

25 MS. DeSANTI: Yeah, Mr. Scott, I wanted to address

1 some of the policy questions. As the Chairman says, it's
2 hard to discuss some of these issues that you have raised.
3 There, obviously, may be factual disputes. You have one
4 view of the facts and there are some --

5 MR. SCOTT: Mine are always right. They're
6 logical.

7 MS. DeSANTII: -- views.

8 I have no doubt that you put together everything
9 in a logical manner. I have full confidence in your ability
10 to do so.

11 But what I'm hearing on the issue of competition
12 and three versus two and two is fine to have a fully
13 competitive market, I'm hearing more from you about
14 efficiency gains and this is just a fact of life.

15 Can you tell us something more about other markets
16 in which you currently operate where there are two
17 competitors, yourself and some other, and how does
18 competition operate in those markets, that would give us
19 more confidence?

20 MR. SCOTT: You know, that's -- I can't think -- I
21 guess the only place where you would only have -- that I can
22 think of -- that you only have two competitors are in
23 smaller towns, where you only have two.

24 Here's typically -- if you go to a typical larger
25 market, the -- you end up having fewer -- you have more

1 competitors than this. But here's what happens in the
2 marketplace. We go in and we're building up a -- you know,
3 a delivery system. Okay? And you do that primarily by
4 buying because it doesn't make sense to build a lot of new
5 hospitals in this country.

6 What happens is our competitors, which most of
7 them are tax-exempt competitors, they don't have an interest
8 generally of consolidating their balance sheets and their
9 income statements. So what they do is they create
10 alliances; and they say, we are all going to work, you know
11 this group of 6, 10, 20 hospitals -- probably not that many
12 -- 6 to 10 hospitals, we're all going to work together and
13 go work with managed care players as a group. Okay?

14 And so what you'll end up having in a lot of
15 markets, you'll have us; you'll have a tax-exempt
16 affiliation; and then you'll have a group of independent
17 facilities that become very dependent upon Medicare and
18 Medicaid because that's the only thing that they can
19 attract.

20 That's what happens more.

21 We even had an example where in -- down in New
22 Orleans, where -- I can't remember the number of these, but
23 it's something like 8 or 10 hospitals after we went into
24 that market, tax-exempts -- they all agreed that they
25 wouldn't sell to us for 18 months; and they created, you

1 know, an environment that they're going to work together
2 with managed care, you know, to combat us. Because, you
3 know, when we go into a marketplace, a lot of times people
4 are concerned about our position.

5 Because no one's ever done it before.

6 MS. DeSANTII: When you say for 18 months they
7 wouldn't --

8 MR. SCOTT: They signed a document. They will not
9 sell to us -- not negotiate to sell to us for 18 months,
10 because they're all worried that they are going to be -- you
11 know, they're all worried that they're going to be the last
12 one out there; and they know that they -- they look at the
13 numbers in California and the days per thousand in
14 California, and they look in places like New Orleans or in
15 other places and they say, you know, if that happens here,
16 golly, we're in trouble because we don't need, you know,
17 eight times the number of beds that they use in California.

18 And so they know that they're going to have to
19 consolidate or they're going to slowly, basically, bleed to
20 death. They're not going to spend any capital. They're not
21 going to keep the employees.

22 So, I mean, there's a lot of concern right now in
23 the industry about what's going to happen to them.

24 MS. DeSANTII: But at the moment, you don't really
25 have a lot of markets in which there were one or two?

1 MR. SCOTT: I guess Tulane has a good delivery
2 system in New Orleans; but you have, you know, a lot of
3 tax-exempt. I can't think of -- other than smaller towns,
4 where you have just -- where you have two.

5 Probably Orlando is -- Orlando is an unusual
6 market. You generally don't have two or three, yet -- I
7 mean, there's almost no independence left in that area.
8 That's still pretty unusual. That's where it's going to go,
9 but it's unusual.

10 MS. DeSANTI: Okay. And can you give me a rough
11 sense -- there are a lot of statistics in your testimony --
12 but I don't think we have the number of hospitals that
13 Columbia has acquired over, say, the past 5 or 10 years.

14 MR. SCOTT: I could get you the numbers. You
15 know, we've done these big mergers. And I think HCA was 96
16 hospitals; Galen was 71 hospitals; Medical Care was, I
17 think, 96 surgery centers; Basic American, I think, was 8
18 hospitals.

19 But in this -- you know, we're adding -- we'll add
20 -- I couldn't give you an exact number. But we'll continue
21 to add hospitals primarily in markets where we're already
22 located. But we're going -- like last week, we went into
23 Cleveland, Ohio; Canton, Ohio; and Columbia, South Carolina,
24 where we had not been. And we're going into Massachusetts
25 and Rhode Island where we had not been.

1 We've really not been, historically, in the North,
2 many tax-paying, investor-owned hospitals, because of the
3 companies that did the mergers which were started at a time
4 when all the growth was in the South; and certificate of
5 need laws prevented them from getting into the business in
6 the North primarily.

7 MS. DeSANTII: I have just one last question, which
8 is, there are a lot of very interesting statistics in your
9 testimony. And I'm wondering if you could provide us with
10 the citations for that so that we can follow up on this as
11 well?

12 MR. SCOTT: All these are basically employees of
13 our company that got all these numbers.

14 I mean, I can get you the data where they --

15 MS. DeSANTII: Well, just a few of the key sources
16 would be of interest --

17 MR. SCOTT: Okay. I can do that.

18 MS. DeSANTII: -- because this is very interesting
19 testimony, and we would like to see more of the basis.

20 MR. SCOTT: Okay.

21 COMMISSIONER STEIGER: And just to make sure the
22 record reflects it, is it accurate to say that of the
23 substantial number of mergers that you have accomplished in
24 recent years Commission action has affected 10 hospitals?

25 Is that the correct number?

1 MR. SCOTT: I think it's 10 hospitals.

2 COMMISSIONER STEIGER: Thank you.

3 MR. SCOTT: But it's still 10.

4 MS. VALENTINE: Just one more quick question. I
5 also find the efficiencies -- you've achieved them, what
6 areas they are in, whether it's management reduction or
7 marketing savings -- interesting; and I want to know a
8 little bit also about where they're going, what you're doing
9 with them.

10 At one point you said that your -- that if one is
11 not able to make cost savings through consolidation,
12 hospitals will not be able to invest in new technologies in
13 the future.

14 What percentage of your cost savings are going to
15 investments in new and improved technologies?

16 MR. SCOTT: Well, I mean, I don't think it's a --
17 you know, what your -- the way -- here's the way -- it
18 doesn't really operate that way.

19 We -- well, in -- Medicare and Medicaid has not
20 stayed up with inflation since 1983. And we're seeing
21 significant reductions. We have states like Kentucky that
22 passed provider taxes that's \$18 million dollars a year.
23 That's \$18 million dollars out of our cash flow stream.

24 So, then you have -- you have -- whether it's
25 companies like General Motors or you have insurance

1 companies that are demanding reduced reimbursement
2 constantly. And they're getting it, because it's a very
3 competitive marketplace.

4 And so we're on that side figuring out how we can
5 streamline the process and try to move the industry to be
6 more value driven by providing better outcome information,
7 patient satisfaction information, things of that sort.

8 Now, the capital expenditure decisions are: How
9 can we -- where you have a certain percentage; and each year
10 it's generally a third to a half of our capital expenditure
11 is basically renovation of existing physical plants because
12 they're old, adding and replacing existing technology
13 because it's old or it needs to be updated, things of that
14 sort.

15 And then you have other capital expenditures that
16 are going for -- it would be a third to a half, depending on
17 how you look at it.

18 Just looking at new services that we can provide
19 -- because, you know, in this industry there's constantly
20 new services that are being provided. But -- and, you know,
21 the dollar -- as an example, we're spending \$170 million a
22 year on information systems. That's efficiency directed.

23 But I couldn't tell you a percen- -- you know --
24 that's not a good answer, I guess; but it's the best I can
25 do.

1 CHAIRMAN PITOFSKY: Thank you very much for some
2 really fascinating testimony.

3 MR. SCOTT: Thanks.

4 CHAIRMAN PITOFSKY: Our next participant is Phil
5 Proger, a partner at the law firm of Jones, Day, Reavis &
6 Pogue, where he has practiced since 1989.

7 Mr. Proger is coordinator of the firm's Government
8 Regulation Group. And in his antitrust practice, he pays
9 special attention to mergers and acquisitions as well as the
10 application of antitrust law to the delivery of health care
11 services.

12 He is, among other things, a member of the
13 editorial boards of Managed Care Law Report and Healthcare
14 Systems Strategy Report and publications officer of the ABA
15 Antitrust Law Section.

16 I must say that when I was an academic, before I
17 came over here, when I had a health care question, I called
18 Phil Proger; and, therefore, it's a special pleasure to
19 welcome you to these hearings.

20 MR. PROGER: Thank you, Mr. Chairman.

21 Is this on?

22 CHAIRMAN PITOFSKY: Yeah.

23 MR. PROGER: Can you hear it?

24 I'm here today on behalf of the Alliance for
25 Managed Competition, which is Aetna, CIGNA, The Prudential,

1 and United Health Care, which, together, purchase health
2 care coverage for over 60 million Americans.

3 The Alliance for Managed Competition believes very
4 strongly in the continued enforcement of the antitrust laws
5 in the health care industry and believes, as I will testify,
6 that the antitrust laws have done a great deal to enable the
7 current health care system to develop.

8 And in answer to the question posed to this panel,
9 whether the antitrust laws impede businesses, in this case,
10 the health care industry's abilities or efforts to obtain
11 efficiencies, the Alliance for Managed Competition believes
12 that, in fact, the antitrust laws have facilitated the
13 ability to obtain efficiencies, not impeded that ability.

14 When we talk about efficiencies, we're talking
15 about not only the reduction of cost but the enhancement of
16 quality and then the enhancement of services.

17 I must confess, I have done prepared testimony
18 which I will leave, but you have given me a difficult
19 assignment, to follow Mr. Scott and Mr. Cubbin. And I think
20 -- I've made some notes, and I'm going to deviate a little
21 bit and talk about, I think, some of the issues raised.

22 It strikes me, at the outset, that there are some
23 things that everyone can agree on in this debate, as
24 illustrated by both their testimonies.

25 And that is, one, there is an enormous amount of

1 efficiencies to be obtained yet in the health care industry.

2 Prior government intervention in this industry
3 resulted in the lack of market forces in the industry, which
4 resulted in, frankly, a very inefficient over-built industry
5 that, by the beginning of 1980, which is really when
6 competition began to be seriously injected into the health
7 care industry, left us in the current situation we have.

8 And as Mr. Scott correctly testifies, there's
9 enormous excess capacity in, particularly the hospital fixed
10 cost industry. Most of you -- you are well aware of the
11 history with Hillburton and other federal statutes that
12 encouraged, regardless of cost, the building of neighborhood
13 hospitals that would be fully equipped, opened seven days a
14 week, 24 hours a day, with emergency rooms, and a great deal
15 of redundancy.

16 We, as a nation, really did not care about the
17 cost of our health care system. We wanted it convenient,
18 and we wanted it high quality.

19 Beginning in the '70s, we began to recognize that
20 there were certain costs associated, as a society, to that
21 type of health care delivery system. And seriously
22 beginning in the '80s, we have used competition as hopefully
23 a way of trying to enhance the delivery of services yet
24 eliminating some of the over-capacity.

25 So I think, at the outset, we can agree that

1 there's a great deal of efficiency in the industry. I think
2 we can also agree that since 1980 competition has made
3 significant strides in dealing with those issues.

4 Frankly, it is the antitrust laws that -- whose
5 enforcement way back in 1940's in the District of Columbia
6 has permitted the current state of managed care in a variety
7 of innovative and new forms of competition, and I think
8 opened up the markets to the remarkable things that Mr.
9 Scott has done in putting together Columbia HCA and other
10 organizations.

11 Since 1980, what we have seen is the growth of
12 managed care, the horizontal consolidation of the hospital
13 industry, the formation of integrated delivery networks, the
14 formation of vertically integrated health care entities.
15 Mr. Scott testified, for example, about the situation in
16 Salt Lake City.

17 I would just add to that, just to point out, that
18 one of things Inter-Mountain Health Care has done is created
19 an integrated delivery network where the physicians own, as
20 he points out, half the hospitals in Utah, offer its own
21 insurance product and goes directly to the marketplace.
22 Similarly, for example, Henry Ford in Detroit, Sentura in
23 Norfolk have done the same thing.

24 If anything the transformation of the industry is
25 accelerating not declining. So what we're seeing is an

1 industry that is undergoing rapid transformation in a
2 relatively short period of time. If you look at sort of the
3 scheme of industries, 15 years is a relatively short period
4 of time for competition to have done what it has done here.
5 And it's produced enormous efficiencies.

6 So I think we can all agree that there are
7 enormous efficiencies in this industry. I don't think
8 that's the question. I think the question is, as you
9 produce these efficiencies, how do you ensure that the
10 efficiencies are going to be passed on to the consumer? And
11 I think that's the key issue.

12 I think we all agree that there are two possible
13 ways you can do that. One is through competition in which
14 the competitive forces force the recipient of the
15 efficiencies to pass them on to the consumer in the form of
16 either lower costs or higher quality or better services.

17 Or we could try a regulatory model. I, myself, on
18 behalf of the AMC, is highly skeptical to the regulatory
19 model. I point out that it was that model that did get us
20 into the situation we're in today.

21 If you look at the data as it now is beginning to
22 come in -- some of it done by economists at the Commission
23 and former economists at the Commission -- what you discover
24 is in markets where we have now begun to see competition
25 over a prolonged period of time, like Southern California,

1 it is clearly out-performing regulated markets like my own
2 native state, Maryland, where the costs initially look more
3 favorable under the Health Service Cost Review Commission of
4 Maryland.

5 And now as you're seeing the effect of competition
6 in California, you're see it dramatically out-perform the
7 regulated environment of Maryland. So places like
8 California, Minnesota, and some of the markets where
9 competition has now reached a more mature state are doing
10 what we would expect it to do.

11 Absent competition or regulation, the efficiencies
12 are not going to be passed on to the consumers.

13 So I think the real issue is, we have to answer
14 two questions:

15 Does competition work in health care?

16 And, secondly, has antitrust enforcement or even,
17 as pointed out, the perception of antitrust enforcement
18 deterred conduct by providers to principally hospitals and
19 physicians that was and is, one, lawful and, two, would have
20 created efficiencies that would have been passed on?

21 I think the answer is:

22 One, competition does work in health care, not
23 perfectly. As has been pointed out, there are information
24 flow problems. There are quirks to the industry. But what
25 we have discovered over the last 15 years is, like any other

1 industry, in the United States, it is susceptible to
2 competition. I think there are issues in rural markets. I
3 think there are issues in some other markets. Clearly,
4 competition raises issues of access and coverage.

5 Let me suggest to you that's the wrong question to
6 put to competition. I don't think competition needs to be
7 responsible for access and coverage. That's more a national
8 policy issue and a financing issue than a competition issue.
9 What competition gets to is how we ensure that consumers get
10 the best quality, the best services, and the lowest prices.

11 Has antitrust enforcement deterred pro-competitive
12 collaborative conduct that would produce efficiencies?

13 Well, certainly the presence of antitrust has been
14 a deterrent to some people. I think the perception is a
15 real issue. We have all talked about it at length. The
16 Commission and the Department of Justice, on September 15 of
17 '93 and September 27 of '94 issued policy statements to
18 address this.

19 As Commissioner Steiger pointed out in her
20 questioning, there is an ability to have advisory opinions.
21 I haven't looked in the last few days, but there's well over
22 30 advisory opinions under this policy which, since 1994, is
23 fairly a lot.

24 But, nevertheless, there are still some in the
25 industry who say they would do things, but they are

1 concerned about antitrust. I think that's just inherent in
2 the situation. I commend the Commission and the Department
3 of Justice for its constant efforts to issue advisory
4 opinions and to give speeches.

5 I think Mark Horoschak said that at times you get
6 tired of the whining in the industry because there was no
7 industry that had received so much attention with such
8 little gratitude; and I think there may be some fair comment
9 there. But I think you've got to continue to do that so
10 that people get the message.

11 But when we ultimately look at what is going on
12 here, what we're really seeing is two basic things happening
13 that are producing efficiencies. One is the elimination of
14 the excess capacity in the hospital industry; and, two, the
15 formation of horizontally and vertically integrated
16 networks.

17 Now, in each of those situations, the analytical
18 model of the antitrust -- of the policy statements and of
19 the Merger Guidelines applies. On one hand, we weigh the
20 anti-competitive effects of market power and collusion with
21 the pro-competitive effects of efficiencies.

22 It strikes the Alliance for Managed Competition
23 that there is very little benefit to the society or to the
24 consumer for enormous efficiencies unless it can be assured
25 that there isn't market power collusion so that those

1 efficiencies are passed on to the consumer.

2 Competition is dynamic. It is constantly
3 changing; and I think, as Mr. Scott points out, we have to
4 be aware of the changes in the competitive marketplace to
5 determine whether or not these transactions that produce
6 these efficiencies still remain or leave enough competition
7 behind to ensure that the efficiencies are passed on.

8 In that regard, I think it is important that we
9 recognize the the formation of integrated delivery networks
10 is moving the industry from an atomistic in-patient hospital
11 competition where collusion I think was easier than it is on
12 a vertically integrated differentiated product that is going
13 ultimately to the purchaser like the Alliance for Managed
14 Competition or, in some cases, directly to corporations like
15 General Motors.

16 Although, as the Chairman points out, there are
17 probably few industrial corporations or other entities --
18 buyers in the United States that have that degree of
19 sophistication to go at it alone. Most of the purchasers
20 today do purchase through Blue Cross or the companies in the
21 Alliance for Managed Competition or other -- the numerous
22 insurers. The actual financing market, as you're well
23 aware, is a highly de-concentrated, highly competitive
24 market.

25 So clearly the role of purchaser remains key here.

1 But as you look at these issues, and as set forth in one of
2 the examples to the policy statements, you need to look at
3 the role of the purchaser in ensuring that efficiencies are
4 passed on.

5 There may be markets, particularly in rural areas,
6 where, as Mr. Scott points out, you're not going to have
7 more than two networks competing against each other. I
8 think the role of the process of the antitrust laws is to
9 ensure that there's a maximum amount of competition so that
10 the maximum amount of efficiencies are passed on.

11 I think there are things you can look at. If you
12 look at the examples under the guidelines, particularly
13 under the policy statements, particularly in the area of the
14 physician networks and the multi-provider networks, there is
15 a real distinction made for risk sharing for integration,
16 which, obviously, stems from the per se rule itself as
17 opposed to the rule of reason.

18 Nevertheless -- and I think in a number of
19 markets, because of culture, because of other reasons -- the
20 markets may not be prepared totally for full integration
21 and, yet, would be enhanced by the formation of networks
22 that can act as a single actor but have to deal with the
23 spillover issue but still could act as a single actor and
24 yet doesn't have integration.

25 As the present policy statements are set up, as

1 the present situation in the area is, it's very difficult
2 for physician and hospital groups to get together and form
3 any kind of meaningful competitive alternative unless they
4 were prepared to integrate or take capitation, which isn't
5 always possible.

6 The other thing that we would suggest that the
7 Commission might consider is under what circumstances would
8 efficiencies be considered and what level of proof must be
9 satisfied by the parties.

10 You, the Commission, yourself, in different
11 speeches and documents have indicated some thought on this.
12 And, of course, Section 4 of the Merger Guidelines deals
13 fairly extensively with efficiencies, as do the policy
14 statements, which follow the Merger Guidelines in this area,
15 at least in the analytical approach.

16 Today's efficiencies must be merger specific. And
17 some even argue that it has to be that particular merger
18 specific, meaning that if there is another less
19 anti-competitive merger that the parties -- one of the
20 parties could engage in, the efficiencies will be
21 discounted.

22 I think that doesn't take into account
23 realistically some of the practical realities of what goes
24 on in marketplaces and the recognition that sometimes it
25 takes a cataclysmic event like a merger to create the

1 necessary culture to allow the efficiencies to occur.

2 And I grant that it is important to make sure that
3 the efficiencies that are occurring are ones that are real
4 and ones that will be achieved after the merger. But if
5 there's sufficient competition after the transaction, say,
6 for example, a hospital merger, then I think we are too
7 harsh in forming sort of mechanical tests of where the lines
8 of efficiencies are by discounting all efficiencies that
9 could have been achieved otherwise or through a different
10 transaction.

11 Secondly, the level of proof, exceedingly
12 difficult to do in these transactions. Exceedingly
13 difficult as the guidelines point out, particularly in
14 non-manufacturing efficiencies, to be able to quantify and
15 demonstrate them.

16 Further, to Mr. Scott's point, I have seen some
17 transactions where, in hindsight, we're looking at \$20
18 million a year savings, \$200 million over 10 years, which is
19 really real.

20 I don't think the issue is the magnitude of the
21 efficiencies. I think the issue is whether there's enough
22 competition to ensure that they get passed on.

23 So, in conclusion, the Alliance for Managed
24 Competition clearly supports the continued enforcement of
25 the antitrust laws in the health care industry; believes

1 that, by and large, the Commission's policies in this area
2 and enforcement have been well thought out and well done;
3 believes that the antitrust laws do not impede business's
4 efforts to obtain efficiencies.

5 We respectfully suggest that the paradigm is to
6 encourage collaborations that produce efficiencies but only
7 to the extent that, afterwards, there is enough competition
8 to ensure that the efficiencies will be passed on.

9 It's a balancing act, but it's one that's done
10 every day. It's the very core of antitrust analysis. And
11 we think that it can be quite successfully done in the
12 future as it has been done in the past.

13 I would be happy to answer any questions.

14 Thank you for the time.

15 CHAIRMAN PITOFSKY: Thank you. You've probably
16 had as much experience with efficiency claims in hospital
17 and health care deals as anybody. Hard to do, you say? I
18 mean, hard to quantify? How hard is it?

19 We've had some testimony that it's a shell game,
20 that people come in with these claims, they put together
21 economic reports; but, in fact, they don't know if they're
22 going to be efficiencies; and certainly the Commission
23 doesn't know.

24 Is that your sense, that it's so amorphous that
25 it's an unreliable indeterminate factor?

1 MR. PROGER: Mr. Chairman, I confess I have been
2 unpersuasive, as most, on this subject.

3 I don't think it's a shell game. I think, to some
4 extent, the way we're doing it causes it to be that way.

5 Let me divide this into two different issues.

6 One: Are there real efficiencies to be achieved
7 in the formation of these horizontal and vertical networks?

8 I think, my experience is, absolutely, yes.

9 Two: How do you go about proving them?

10 Let's talk about some of the practical problems.

11 One is, in a Section 7 context -- we're talking about the
12 future. It hasn't happened, and we've got to predict it.

13 Two: In many of the communities where this is now
14 occurring, you have situations where what you're really
15 talking about is the elimination of FTE's, the elimination
16 of -- sometimes of an entire facility.

17 Very fragile thing to talk about in a community
18 before it's happened, particularly -- to be exceedingly
19 blunt -- if you don't know that the antitrust
20 Hart-Scott-Rodino process will lead to a government
21 challenge of the transaction so that when you're done, you
22 may have wounded yourself and not had the transaction.

23 In order to really determine whether or not you're
24 going to achieve efficiencies, what you really need to do is
25 get into the bowels of that organization, sit down with the

1 medical staff, really understand how they practice, really
2 understand how they can consolidate.

3 The real savings are in clinical programs. And my
4 experience is, that's a real balancing act. Because, on one
5 hand, if it's a difficult transaction but there's
6 significant efficiencies, you have to weigh how much risk
7 you're going to put your organization to. Because once you
8 expose it to the medical staff, you're going to have some
9 physicians thinking there's winners and losers; they're
10 going to shift; you're going to have people switching for
11 jobs; and you may not be able to put, frankly, Humpty-Dumpty
12 back together again.

13 So what often people do is hire one of the
14 professional consulting firms, usually a big six accounting
15 firm, to go through with people who are essentially
16 industrial engineers.

17 And, depending on the degree that they go, go
18 through department by department and look at what can be
19 obtained.

20 Is it a shell game? I think it often is a
21 realistic expectation of what you can do at the best case.
22 Whether you will achieve it or not is going to depend on a
23 changing market, the willingness of physicians to go along
24 with it, your own willingness often as a non-profit board --
25 this is usually the case we're talking about -- to sort of

1 survive the wrenching experience, particularly if it means
2 closing one of your facilities.

3 But they're there. And I think what competition
4 is doing is forcing people to come to grips with this issue
5 and forcing people to deal with it.

6 So is it a shell game? I think it can be; but in
7 most cases, I think it's real.

8 The shell game is proving it.

9 COMMISSIONER STEIGER: Just one brief question. I
10 asked Mr. Scott about excess capacity. You, too, have had
11 extraordinary experience, Phil; and we very much thank you
12 for sharing it with us today.

13 I believe I heard him say that at the present time
14 the excess capacity needed to handle peak load was between
15 10 and 20 percent and, indeed, that it would vary regionally
16 depending upon population shifts. I think his original
17 figure was that there is now 35 percent over-capacity.

18 It is possible to take a snapshot and suggest how
19 much over-capacity is, indeed, required for successful
20 management?

21 And is this going to change dramatically, as I
22 believe Mr. Scott suggested, with shorter hospital stays?

23 And I may apologize in case I am misstating
24 anything that Mr. Scott said.

25 MR. PROGER: Well, I certainly want to defer to

1 Mr. Scott's expertise. I'm a practicing attorney and have
2 never run a hospital, let alone a hospital corporation.

3 I do have the benefit of, not in my present
4 capacity today, but actually in my real life of having been
5 a hospital trustee of a system for a number of years. And
6 I'm the immediate past President of the American Academy of
7 Hospital Attorneys of the American Hospital Association,
8 where I, vicariously, have picked up a fair amount of
9 information on this.

10 My understanding is that, essentially, a hospital
11 that's operating between 80 to 85 percent is pretty much at
12 capacity. You have weekends. You have seasonable problems,
13 such as the summer in Florida, winter in some of the
14 northern states, where there are certain demand changes.

15 If you're at 85 percent, that means that during
16 the week, you're at a higher percentage -- on the weekend
17 most people try and be discharged if they could and you're
18 at a lower percentage -- you're pretty close to capacity on
19 your in-patient side.

20 I think some can argue it's 90 percent.

21 There's a real issue, by the way, as to what you
22 call "capacity" in this area. Most states have licensed
23 beds. With the decline today in demand on the in-patient
24 side, we're seeing more and more hospitals that have, say,
25 400 licensed beds but 30 in-service beds and 250 staff beds

1 for that particular day as hospitals are trying too wrench
2 down their costs and respond to the marketplace. Some of
3 this now gets moved to out-patient services, and you have to
4 factor that in.

5 Quite outstanding, to me, having watched this
6 since 1973, we're on the verge of 50 percent of hospital
7 revenues or more will be out-patient as opposed to
8 in-patient. So the business is really changing.

9 But I think on the in-patient side, say 80 to 90
10 percent is somewhere the range of what a fully -- a full
11 hospital would be on an appropriate weighted capacity; you'd
12 have to agree on the number, but I think you would look at
13 staff beds with the understanding, in short order, they
14 could move up to end-use beds and then de-mothball the beds
15 up to their licensed capacity. Then in terms of the excess
16 capacity, the number he gave of 40 percent is the one that I
17 have universally heard.

18 I think you can't look at it universally. I think
19 you have to look in the particular market you're in. But in
20 a lot of markets today in the United States, there's 40, 50
21 of excess capacity, even on these rated numbers

22 COMMISSIONER STEIGER: Very useful. Thank you
23 very much.

24 COMMISSIONER STAREK: Phil, do you think the
25 current version of the Merger Guidelines and the two policy

1 statements adequately provide guidance for the way the
2 enforcement agencies view efficiencies and the kinds of
3 efficiencies that the enforcement agencies will take into
4 account?

5 MR. PROGER: Well --

6 COMMISSIONER STAREK: And how they will analyze
7 them?

8 MR. PROGER: You know, I think you get into a
9 philosophical question, Commissioner Starek, as to how far
10 you go in guidelines. I've always been amazed that you put
11 out the guidelines and you put out the policy statements,
12 because I'll confess, as a practicing lawyer, to the extent
13 I can use them to my advantage, I always will.

14 It seems to me that Section 4 of the Merger
15 Guidelines is not a very detailed statement of how to look
16 at efficiencies. And, accordingly, the policy statements
17 which incorporate them, I think suffer that frailty.

18 And, particularly, if you look at what has become
19 the practice now, particularly at the Commission and over at
20 the Department of Justice, which always uses Dr. Taylor, the
21 actual process of looking at efficiencies is very different.
22 It's a very line-by-line, score-by-score analysis that is in
23 great detail.

24 So, I guess my answer to your question is I don't
25 think the current guidelines or policy statements do

1 represent the actual analysis that's done in a particular
2 situation.

3 Having said that, I'm not sure -- because I have
4 thought about this; and I confess, I haven't thought of a
5 better way to say it than it's presently there -- that it's
6 so factually unique, which is the basis of the flexibility
7 of the antitrust laws -- there's always this debate between
8 predictability and flexibility. We can create bright lines
9 that make it much more predictable, but we're going to fence
10 outside of those bright lines a lot of lawful conduct, a lot
11 of lawful efficiencies.

12 I guess, from my own standpoint, I still think the
13 key issue is competition, not efficiencies. And weighing --

14 I will make two comments.

15 One is -- and I think this applies to the overall
16 Merger Guidelines process and not just efficiencies -- I
17 think we're in danger of becoming too mechanical with them.
18 I think that they are a good analytical tool. They are a
19 good way of thinking about things.

20 But whether entry could occur in 23 months or 25
21 months, to me, doesn't seem to be like a significant
22 difference; and yet I hear people now saying, "Well, it's
23 now 24 months; and you've got to be within that time
24 period."

25 The same with efficiencies. The guidelines say

1 they have to be efficiencies that you could only achieve
2 through this transaction. I think actually they say
3 "reasonably." And I think we really have to look at that
4 because I'm not sure I know what that means. I think, as a
5 practical matter, in many instances the only way you're
6 going to achieve these efficiencies is if you do this
7 merger.

8 Having said that, I confess to you that, in fact,
9 you could have downsized and achieved the efficiencies; but
10 your organization just didn't have the culture, didn't have
11 the wherewithal to do it; it's too wrenching and too
12 destructive to do it, unless you have this kind of major
13 event to surround yourself in.

14 So, as I suggested in the testimony, I think
15 that's one area I would look at. But only if you still have
16 enough competition to ensure that those efficiencies are
17 passed on.

18 CHAIRMAN PITOFSKY: Susan?

19 MS. DeSANTI: Yes. You focused us on the key
20 issue of what's enough competition. And it seems to me to
21 relate to the issue raised in Mr. Scott's testimony as well
22 as in the hospital markets, what's enough competition.

23 And I'm wondering if you can give us some guidance
24 from the Alliance's experience, as purchasers of health
25 care, a representative of customers in the health care

1 process, what's enough competition?

2 Purchasing from two hospital networks? Three
3 hospital networks? Four networks of providers?

4 I assume there isn't any magic number. I have yet
5 to find any magic number in life. But can you give us some
6 sense of how the dynamics of competition work and what are
7 the key aspects that we should be looking for?

8 MR. PROGER: Yes. That's actually very, very
9 thoughtful but almost an impossible question to answer for a
10 number of reasons.

11 One is, we're in an evolving state where the
12 markets are changing and it depends market by market.

13 I think from the Alliance's standpoint, purchasing
14 health care for 60 million Americans, we want to be able to
15 purchase in the most efficient way, the most efficient
16 health care services; we want the highest quality, the
17 highest service at the lowest possible cost.

18 Obviously, depending on the circumstances of that
19 market, it will vary. I think there are some common
20 denominators.

21 One is clearly we are moving to a medical
22 management on an integrated delivery basis. And, therefore,
23 the move to horizontal and vertical integration is helpful,
24 particularly as we talk about what is, in the industry,
25 referred to as a continuum of care. That is, to position

1 the patient, you and I, in the highest quality in service,
2 lowest cost situation.

3 And by the way they're not necessarily,
4 incompatible. For example, Mr. Scott talked about open
5 heart procedures and the success they have had at the Miami
6 Heart Institute. We know there is a high correlation
7 between volume and morbidity, mortality; the higher the
8 volume, generally, the lower morbidity, mortality.

9 And it, interestingly enough, doesn't occur in the
10 general surgeon who does -- the cardiac surgeon who's making
11 the incision. They're usually reasonably high-skilled
12 people. You get your efficiencies and your higher quality
13 in the redundancy of the back-up people, respiratory
14 therapist, the physical therapists, the rad techs, you know,
15 all those people who are supporting the procedure and need
16 to be there when something goes wrong. And the higher the
17 volume, the better you are.

18 So we want integrated networks. We want
19 redundancies. We want high volume. And yet we want enough
20 choice that we can make them compete against each other so
21 we get a competitive price.

22 Could two do it? I really don't have the
23 empirical answer to that. I defer to some of the people who
24 are looking at this. I think that you could have markets
25 which are very differentiated and very hard for collusion to

1 occur; and if people are purchasing as a powerful purchaser
2 in the right way, maybe two could do it.

3 But I think it may differ with your General Motors
4 or your Phil's Pizza Parlor as to whether or not you're
5 going to succeed in getting that.

6 I think the best thing is that, given what minimal
7 efficient scale is, you want as many minimally efficient
8 scales -- as many efficient competing networks as you can in
9 the marketplace.

10 MS. VALENTINE: Okay. I guess I would have asked
11 you to get at that same question by commenting on Mr.
12 Scott's two proposals, whether eliminating the use of the
13 concentration presumptions and presuming that two or three
14 are a sufficient number of hospitals to maintain competition
15 would be things, you know, things that you would find
16 acceptable for ensuring adequate competition to pass these
17 efficiency savings on to consumers.

18 So if you want to add one more thought on that, go
19 ahead.

20 My question, separate from that, is: There are
21 two theories in our efficiency literature. One is that,
22 sort of the Areeda/Turner version, in declining or stable
23 markets, we should allow consolidations for efficiencies. I
24 think our Chairman looks sometimes to efficiency gains from
25 mergers in expanding markets so that we can be stronger

1 competitors globally.

2 Does it make any difference in the hospital
3 context for us whether we are looking at a declining or a
4 stable or expanding market in terms of realizing real
5 efficiency gains?

6 MR. PROGER: Well, the first part first.

7 I'm not sure the Alliance for Managed Competition
8 necessarily has looked at that particular issue.

9 My own view is that -- it's the point I was making
10 earlier -- which is analytically, I think it makes a lot of
11 sense to look at the concentration in the marketplace.
12 Whether or not 1,000 or 1800 make a lot of sense in the
13 hospital industry, particularly on the in-patient side, I
14 think is an entirely different question.

15 The fact of the matter is, as Mr. Scott points
16 out, in many markets -- he pointed out Salt Lake City -- if
17 we take that position and we apply a mechanistic rule to it
18 that that's the bright line, it will be very predictable,
19 but there will be no transactions.

20 So I think you've got to go beyond it. I think
21 you've got to get to the market power, you've got to get to
22 the collusion issue, and that you can't get yourself stymied
23 on the bright line of 1800.

24 On the other issue you raised, I confess, you have
25 been kind enough -- some might say "foolish" -- to invite me

1 back next week when that's the question we are going to be
2 talking about; and I'm not sure how much you want to get
3 into it.

4 I don't think that you can really say this is
5 necessarily a declining industry. What it is, is an
6 industry in dramatic transformation where parts of it are
7 growing and parts of it are declining.

8 Clearly the in-patient hospital side is an ailing
9 industry where it is important that the capacity be
10 rationalized and be done so in an orderly way. You can do
11 that, it seems to me, from a regulatory standpoint, which I
12 don't think would be successful; or you can do that through
13 a competitive standpoint.

14 Competition is a relatively slow way to do so. In
15 the meantime, there are many -- just like there's a monopoly
16 rent, there's a corresponding rent that's due to
17 inefficiencies. And I think the policy in antitrust
18 enforcement, again, needs to allow the market, this ailing
19 in-patient industry, to wrench out the efficiencies as
20 quickly as possible, keeping in mind the need to preserve
21 competition.

22 Not an easy task. I don't envy you.

23 CHAIRMAN PITOFISKY: Well, on that "not an easy
24 task," we'll move on. Thank you very much.

25 Our final participant is here to prove that all of

1 antitrust policy is not health care, although sometimes it
2 feels that way sitting where we are.

3 Bill MacLeod is a partner in the law firm of
4 Collier, Shannon, Rill & Scott here in Washington. And from
5 1986 to 1990, he was at the Federal Trade Commission as
6 Director of the Bureau of Consumer Protection.

7 In addition, he served as Director of the Chicago
8 Regional Office at the Federal Trade Commission from 1983 to
9 1986.

10 Bill, welcome back to the FTC.

11 MR. MacLEOD: Thank you very much, Mr. Chairman.
12 And thank you very much also for convening these hearings
13 and giving the Grocery Manufacturers of America the
14 opportunity to comment today.

15 In all that I have heard about efficiencies today,
16 I have not yet heard the contribution of efficiencies of GMA
17 members in the assistance of the industry that we have been
18 talking about all morning long. But I would like to go back
19 through a little history here to consider how innovation,
20 efficiency, and progress in the grocery industry has indeed
21 a very substantial impact and can have an impact on the
22 health care system here.

23 I remember back in the 1950s when I used to go to
24 grandma's house, when she was still around, and she was
25 cooking one of her legendary Sunday dinners, normally what

1 she would take for her cooking fat was whatever had been
2 saved from the last serving of bacon that was sitting in the
3 ice box.

4 When the bacon grease was getting a little bit
5 low, she would go into her can of lard and add a little bit
6 of that lard to whatever recipe needed a little bit of fat
7 to acquire the taste that she was so good at putting in
8 there.

9 Well, we all know that around the '50s and '60s we
10 started seeing vegetable shortening largely taking over for
11 the cooking fat that was going into our foods. And more
12 recently canola oil and even more exotic formulations of
13 cooking materials that GMA manufacturers have come forward
14 with.

15 I dare say that it is probably a safe assumption
16 that we are far better off today by virtue of the grocery
17 manufacturers concentrating on moving from lard to canola
18 oil than we would have been if they had been concentrating
19 on reducing the cost of producing lard and making that a
20 little cheaper, a little less expensive for American
21 consumers.

22 I know you have had a good deal to hear on
23 innovation markets over the last couple of weeks. I
24 remember back in 1983 when I was an attorney-advisor in the
25 Chairman's office we had to deal with an innovation market.

1 There was a transaction that was being opposed by the Bureau
2 of Competition that it proposed to challenge. And the
3 Commissioners, including the Chairman, had to decide on that
4 challenge.

5 One of the issues involved in that transaction was
6 about the research and development in these two companies
7 where there would be significant overlap and where the next
8 generation of products might emerge in this industry.

9 We took a careful look at that issue back then.
10 We asked what would happen to these resources if there were
11 a consolidation between these two firms? What was the
12 synergy that the firms offered? And what was the
13 opportunity for these resources currently employed in R&D in
14 those two companies to continue in that work in other
15 pursuits?

16 As I recall, the transaction was ultimately
17 challenged, but it was settled. But it was not on the basis
18 of the innovation markets, where the conclusion was that
19 probably those markets were reasonably safe from the
20 transaction.

21 What I think is very encouraging and which the
22 members of GMA take with, perhaps I should say "hopeful
23 concern," is that we now have a label for this concept. The
24 label being "innovation markets." And we have been devoting
25 a great deal of attention and study to the issue, which

1 indicates to me that there is almost certain to be a far
2 more sophisticated understanding and treatment of this in
3 transactions that go forward today.

4 Among grocery manufacturers, far and away the most
5 important efficiencies that we have to deal with are the
6 efficiencies that probably get less respect in the
7 literature although, I am glad to say, more recognition
8 among the staff of the Federal Trade Commission than we
9 occasionally see in the literature, but something that I
10 think can still benefit tremendously from a more considered
11 treatment and perhaps more symmetrical treatment.

12 Innovation markets right now we have seen as an
13 issue that has been primarily elevated to a new means that
14 might provide an avenue to attack a transaction, to
15 challenge a transaction. That, of course, is one half of
16 what innovation markets and efficiencies can accomplish.

17 The other half, of course, which we would like to
18 see equally well recognized is that, in transactions where
19 R&D or innovation is at issue, whether that innovation is a
20 cost-lowering innovation or a product-introduction
21 innovation, that the benefits of the transaction to those
22 R&D functions, in those innovation markets, be given equal
23 weight in the consideration of the pro-competitive and
24 potentially anti-competitive consequences of the market.

25 We do not believe that recognition of the

1 efficiencies that are most important to the grocery
2 manufacturers -- and those are the dynamic efficiencies, not
3 the cost-lowering efficiencies, but the ability of a
4 manufacturer to recognize in another manufacturer of grocery
5 products or consumer packaged goods, that there is a product
6 either in the pipeline or currently being produced, which
7 product could be produced far more effectively, which could
8 be marketed far more effectively and which could be expanded
9 dramatically if it were in the hands of a firm that had some
10 abilities that the current holder of those assets did not
11 have, whether those abilities are access to national
12 advertising, whether they were simply a professional,
13 well-experienced marketing group or sales group that has
14 access to distribution or access to information, that could
15 make the product or the research and development far more
16 valuable than it is in the current holder's hands, that is
17 the kind of efficiency that we would like to see recognized
18 equally with those efficiencies that we might be able to
19 demonstrate a 3 percent or 5 percent reduction in the cost
20 of production.

21 Are they difficult to measure? Yes, they are.

22 Are they any more difficult to measure than the
23 relevant market definitions that we have to engage in in
24 every merger analysis? We don't think so.

25 How can they be measured? I agree with Phil that

1 there is a very easy and formulaic way to demonstrate some
2 of these things. I think that those ways are occasionally
3 worthwhile, but they are very seldom persuasive in the
4 context of a requirement that evidence be clear, that the
5 evidence be particularly compelling, that we might be able,
6 in the course of the next two or three years, to take this
7 particular product that this company has not been marketing
8 very effectively for us to market it far more effectively
9 than before.

10 Is it important in an anti-competitive or a
11 competitive analysis of a transaction? It is very
12 important.

13 How important was it when the Kellogg Company
14 decided, back in 1983, that it was going to start to market
15 with regard to the health claims, the health benefits of
16 increasing fiber consumption and increasing that fiber
17 consumption by virtue of eating high-fiber cereals?

18 We know that, number one, that from the studies
19 from the Bureau of Economics that not only did the
20 consumption of the Kellogg cereals increase, the consumption
21 of high-fiber cereals generally throughout the industry also
22 grew dramatically.

23 We are talking about situations, we are talking
24 about markets where, by and large, in the grocery
25 manufacturing industry, when a transaction is being

1 considered, when products are being considered as candidates
2 for consolidation, it is a market-increasing proposition for
3 a particular brand or a particular product.

4 I have performed a modest, unscientific survey of
5 antitrust council for the Grocery Manufacturers in
6 preparation for my testimony today. And what I discovered
7 was that not once in the memory of any antitrust lawyer
8 currently representing the industry have we presented to the
9 agencies a transaction where we thought that the ability of
10 merged firms would be to reduce quantity and raise prices in
11 order to reap the benefits of the merger.

12 That's not to say that we haven't seen a few of
13 those in which at least thoughts were entertained by an
14 occasional executive or sales folks in organizations.

15 We don't present those to you. And the very
16 reason is, because we know that those are the kinds of
17 transactions that run into antitrust difficulties.

18 What have ripened into transactions that the FTC
19 has considered and that the FTC has passed upon are
20 transactions in which the parties can present a credible
21 case for growing a brand, for introducing new forms of a
22 brand, and for growing markets into areas where the brand
23 has not been seen.

24 These are the kinds of efficiencies which are much
25 harder to document, much harder to predict, and envision --

1 or receive much less attention from the academic literature
2 to date.

3 One question that I think is very important -- or
4 at least one distinction that I think is very important is
5 in the question that Phil raised as one of the most
6 important questions of considering efficiencies in health
7 care.

8 One of the advantages of dynamic efficiencies,
9 marketing efficiencies, efficiencies in innovation is that
10 we do not have to ask whether those efficiencies are going
11 to be passed on to consumers.

12 We tend to share the position of the Chairman a
13 little bit more and that the question might be asked a
14 little more often than it needs to be asked. But at least
15 we can say this: When the issue is efficiencies that are
16 taking the form of new products, new marketing, and new
17 distribution, expanded markets, we are already dealing with
18 the assumption that has troubled a great deal of the
19 efficiency debate in antitrust law. We are already dealing
20 with passing the benefits of those efficiencies on to
21 consumers.

22 One of the areas where we find there to be some
23 peculiar asymmetries is that the efficiencies that are
24 recognized somewhat grudgingly but increasingly in merger
25 analysis are efficiencies that are protected very jealously

1 in overall horizontal analysis.

2 There is no question -- and the Federal Trade
3 Commission has been a major player in the development of
4 this -- that any horizontal restraints that in any way
5 interfere with the efficient marketing or other forms of
6 non-priced competition of products are restraints today that
7 receive almost as serious a treatment as naked restraints
8 that deal with price themselves.

9 We have seen this going back to the Indiana
10 Federation of Dentists cases. We have seen it in the Mass.
11 Board of Optometry case. We are seeing it now in a case
12 that you, of course, can't discuss because I believe it is
13 still in Part III before you but in an initial decision that
14 recently came out of the California Dental Association case.

15 A tremendous deal of attention is now being paid
16 at the horizontal level to the kinds of efficiencies and the
17 kinds of competition that efficiencies can drive in the
18 non-priced areas.

19 These are the very efficiencies that the Grocery
20 Manufacturers are trying to project and trying to
21 accomplish, sometimes through mergers and sometimes simply
22 through the ability to market their products on a national
23 and global scale.

24 And that takes me to the third issue -- and I'll
25 conclude with that issue -- in what we believe is one of the

1 more significant threats that remain to those kinds of
2 efficiencies today. And that is the uniformity of an
3 enforcement of consumer protection laws.

4 Like Phil, I will have a chance to address this
5 issue a little more fully a little bit later on in these
6 hearings. There remains a significant concern, not only for
7 the basis of national marketing but also for the basis
8 simply of the transactions that can lead to national
9 marketing that there be constant dialogue between the
10 Commission, the states, and the United States, and other
11 countries so that the benefits that the Commission has
12 obtained in developing its policies with regard to merger
13 analysis as well as consumer protection analysis be benefits
14 that can be shared and understood by others.

15 We believe that one of the finest moments of the
16 Federal Trade Commission in the last few years was the
17 Commission's development and issuance of the Environmental
18 Marketing Guides which have led to a tremendous increase in
19 harmony among the various states, including most recently
20 the State of California where expensive First Amendment
21 litigation over the ability of manufacturers to make green
22 claims has finally come to a conclusion -- or is likely to
23 come to a conclusion -- I shouldn't speak too quickly --
24 because there has been a change in California law that
25 mirrors the change -- that mirrors the guidelines the

1 Commission has set forth in environmental claims.

2 We would like to see the Commission continue this
3 kind of leadership, and we would like to see this kind of
4 leadership extended in one additional area.

5 We believe that in the area of consumer protection
6 regulation, where the achievement of dynamic efficiencies
7 and non-priced competition is at its most vulnerable, is in
8 the area of claims interpretation.

9 We would like to see the Federal Trade Commission
10 develop a policy statement in which the Commission would
11 address the kinds of practices, the uses of evidence, and
12 the weight that it would give to competing interpretations
13 of evidence so that when companies come forward with
14 campaigns like the fiber/cancer campaign of the last decade,
15 there will be some understanding that these kinds of claims
16 are interpreted in a fashion that is consistent, that
17 adheres to the precedent, and that can be reasonably assumed
18 will be applied throughout the United States.

19 We think that there in part is kind of a vicious
20 circle: The more that we recognize dynamic efficiencies,
21 the more that we recognize the importance of non-price
22 competition, the importance of the market for information
23 and the role that plays in the non-price dimensions of
24 competition, the more that will inform the antitrust
25 analysis and the merger analysis and the more that will

1 inform the development of policies in consumer protection so
2 that these kinds of efficiencies can be achieved on a
3 national and even a global scale.

4 Those conclude my comments. Thank you very much.

5 CHAIRMAN PITOFKY: Thank you.

6 COMMISSIONER STEIGER: Let me join in welcoming
7 you back.

8 MR. MacLEOD: Thank you.

9 COMMISSIONER STEIGER: We still miss you, Bill
10 MacLeod.

11 Always fearless. You do address a very difficult
12 issue, and you do address potential competition and how we
13 analyze it.

14 What guideposts should we follow if we are
15 confronted with a need to analyze a transaction that
16 involves a potential competition issue where, to simplify,
17 each party is pursuing a similar R&D development?

18 And the second part of that question is: Do you
19 think those guideposts should be or are different if you are
20 analyzing high-tech industries?

21 MR. MacLEOD: We think high-tech industries are
22 important to the economy, but we are not convinced that the
23 high-tech industries are any higher tech than many of the
24 grocery manufacturers.

25 There is a great deal of attention these days

1 because we herald every couple of years the generation or
2 the next generation of a computer chip that has far more
3 memory and far more speed.

4 I'm not sure that is any more important to
5 American consumers than foods that now have no fat where we
6 had low fat before and foods that had low fat where we had a
7 great deal of fat before.

8 I think that the issue of how to deal with
9 overlapping or complementary or substitutable R&D efforts is
10 something that can be done with perhaps a little more
11 recognition of the various phases of R&D and the extent to
12 which we are truly talking overlaps. And we're talking more
13 about something that might be better classified as a
14 vertical relationship.

15 It is seldom the case -- and once again, if it
16 where the case, it would probably be in the documents; and
17 if it were in the documents, you probably wouldn't see the
18 merger. It is seldom the case where in two grocery
19 manufacturers, they each realize that both is on a race to
20 produce the next version of non-fat, good-tasting bread that
21 is going to sweep the market, and therefore let us try to
22 combine our resources so that neither of us beats each other
23 up and we get out there on the marketplace with our
24 products.

25 Much more often, there is an element of the

1 research in one company that is complementary to another
2 element of the research in another company or to the ability
3 of the other company to put that research into some type of
4 production so that the combination of those two will create
5 a tremendous advantage, sometimes a year or two sooner to
6 the market with the product.

7 That advantage is far more likely to outweigh the
8 possibility that some of the resources that were perhaps
9 overlapping resources in the R&D functions might not
10 otherwise be continuing their independent efforts to come up
11 with slightly different products or come up with two lesser
12 products that are producing in far less efficient a fashion.

13 I think a useful analogy is the two hospitals at
14 40 percent apiece. If we can deliver a product to the
15 American consumer that is 80 or 90 percent better than two
16 products but each of which were unable to achieve the
17 nationwide marketing efficiencies, distribution
18 efficiencies, or information efficiencies, we are probably
19 better off, especially if we can identify that in those R&D
20 departments, as we found back in 1983 with that merger that
21 I had to consider, that very often those resources were not
22 going to disappear; those resources were not going to lose
23 their productive efficiency in the innovation market. They
24 were simply going to be redeployed and would probably be
25 surfacing in the next generation product to come out of the

1 industry.

2 COMMISSIONER STEIGER: One follow up, if I may,
3 then: Do you think that intellectual property
4 considerations weigh more heavily in what has been called
5 the high technology industries as compared to the industry
6 that the grocery manufacturers operate within?

7 MR. MacLEOD: Judging by the discussion and the
8 attention, one would certainly think so.

9 I will say this: I will say that we have been
10 generally very encouraged among the grocery manufacturers at
11 the sophistication that the Federal Trade Commission staff
12 takes to the issue of developing brands, developing R&D,
13 looking at what two companies together might be able to do
14 that the two companies separately might not be able to do in
15 bringing the next generation of product on line.

16 But there is, I think, still a sense that if you
17 don't win that argument at the staff level or if you don't
18 win that argument at the Commission, it will be a little
19 more difficult to win that argument ultimately because there
20 is simply not as much respect paid to those types of
21 efficiencies in grocery manufacturing, for example, as there
22 may be in high-tech computer markets.

23 In saying that, I ought to mention a reference
24 that I did put into my prepared testimony and a reference
25 that I think redounds to the credit of the Federal Trade

1 Commission as well as to a very sophisticated analysis
2 recently done by a federal judge in a merger case in the
3 recent acquisition of the Nabisco Shredded Wheat products by
4 Post.

5 The Commission declined to take action.
6 Nonetheless, there was prosecution by a state attorney
7 general that was brought in Federal District Court in New
8 York, the sum result of which the transaction being upheld
9 and the judge recognizing that far and away the most
10 vigorous form of competition that is prevalent in this
11 industry is competition for innovation, the product
12 introductions, new brands.

13 In one step, the federal judge made the point that
14 I have tried to make today. And the federal judge also
15 vindicated a decision the Federal Trade Commission made a
16 couple of years ago.

17 In preparing for this testimony, Mr. Chairman, I
18 went back to your predecessor, Madam Chairman's speech that
19 she delivered at the 1990 spring meeting of the Antitrust
20 Section, when the Commission undertook to look at a few
21 mergers that the Commission had not challenged and asked the
22 question whether the predictions the Commission had made
23 were predictions that, by and large, were coming true after
24 a year or two following the transaction.

25 The conclusion that she reached was: Yes, they

1 were; the Commission had probably guessed right in those
2 cases -- or certainly predicted right in those cases.

3 "Guess" is not quite respectable enough a term to use.

4 I think, in the Nabisco matter, that is another
5 case in which the Commission can take credit for making the
6 right decision.

7 We would love to see more of those kinds of
8 analyses done, but we would much rather have them done by
9 the Federal Trade Commission in a speech than by a federal
10 judge after long litigation.

11 COMMISSIONER STEIGER: Thank you.

12 And thank you, Mr. Chairman, for the opportunity.

13 CHAIRMAN PITOFISKY: Thank you.

14 Bill, your thought, that some efficiencies might
15 not involve reductions in unit costs, there are other things
16 that might serve that, is an interesting one.

17 Let me refer back to Phil Proger. His suggestion
18 was that efficiencies be taken into account only in a
19 situation where there's enough competition left to ensure
20 that the efficiencies will be passed along and maybe that
21 they're really there and so forth.

22 That suggests to me -- and Phil, you may want to
23 comment on this if I'm not right -- but that suggests to me
24 that you would take an efficiency case into account only in
25 a fairly marginal case.

1 You wouldn't let firms claim efficiencies whether
2 they're financial or innovative in defense of moving to
3 monopoly or duopoly but rather, if a case were close and
4 there's a fair amount of competition left, then an
5 efficiency might make the difference.

6 Is that what your position would be on this
7 efficiency issue?

8 MR. MacLEOD: My position, I think, is much closer
9 to the position that you have laid out in the past.

10 And I think what makes different the consideration
11 of what I'm calling the "dynamic efficiencies" -- and those
12 are efficiencies passed on in the forms of improved products
13 or better information about the products, that are, by
14 definition passed on -- they could be passed on and could be
15 so effective as to render competition obsolete or at least
16 to suspend competition for a while because a firm with a
17 particularly innovative product might be a firm that is
18 serving a market that was served by a number of competitors
19 in the past.

20 If the difference between achieving that
21 efficiency and failing to achieve it is the ability of two
22 firms to combine their resources in a joint venture or some
23 kind of acquisition and the recognition of this joint
24 venture was that it would probably create a new firm with a
25 new product that would have very few competitors, I submit

1 that the welfare analysis of that transaction should still
2 favor the transaction because we would all be better off
3 with vegetable shortening produced by one than with lard
4 produced by low-cost producers.

5 CHAIRMAN PITOFISKY: So you would focus on whether
6 it's a substantial efficiency rather than whether it's
7 likely to be passed on?

8 MR. MacLEOD: In the cases where pass-on is
9 already an issue, I think that's correct.

10 Pass-on, to me, is only a difficult issue when
11 we're talking about the cost-lowering types of efficiencies.

12 The difficulty with pass-ons of dynamic
13 efficiencies, of course, is that we never know for sure
14 whether or not the market is going to buy this proposition
15 that we are offering it. Fiber could have fallen on its
16 face in the 1980s and we never would have heard about it
17 again.

18 CHAIRMAN PITOFISKY: Good.

19 MR. MacLEOD: But we did give that market the
20 opportunity to receive those efficiencies; and as a
21 consequence, the cereal industry was very substantially
22 transformed.

23 CHAIRMAN PITOFISKY: Phil, have I fairly
24 characterized what you had said earlier?

25 MR. PROGER: Well, I think so.

1 I still think the essential issue in weighing this
2 -- and this is the whole antitrust paradigm -- is, if you're
3 going to allow a transaction to go through, is there some
4 mechanism to ensure the consumers are going to obtain the
5 benefits of that transaction?

6 The only comment I would make -- and I really
7 don't disagree with Bill; I've known him for many years --
8 is that I think you've got to look at competition in a
9 dynamic way that Mr. Scott did in his testimony.

10 To go back to that, he was talking about what
11 Columbia HCA is doing in the area of communication
12 management information services, where the physicians are
13 directly hooked into their computer system. Those are real
14 benefits to the consumer.

15 Those are real benefits not only in cost savings
16 but if the physicians beep wherever he or she is and the
17 tests immediately go in so that it doesn't wait until
18 tomorrow morning when they make their rounds, they're real
19 benefits.

20 I presume that Mr. Scott -- I don't know -- and
21 Columbia HCA has made the determination that there is
22 benefit in offering their product to the consumer to,
23 frankly, my clients from testifying here on behalf of CIGNA,
24 Aetna, Prudential, and United in offering this. And this is
25 a part of their competitive dynamic.

1 One must ask the question: If there wasn't that
2 competitive dynamic, do people make the investment? Do they
3 spend the money?

4 So I still think whether it's regulation or
5 competition, there's got to be some mechanism to ensure that
6 the efficiencies are passed on.

7 If they're not passed on, it's just a higher
8 margin, and you're dealing with a wealth transfer.

9 CHAIRMAN PITOFSKY: Debra?

10 MS. VALENTINE: Yeah, actually one question.
11 Commissioner Steiger's questions made me start thinking
12 along these lines.

13 When we're looking at dynamic and innovation
14 efficiencies normally, if you take health care with the FDA,
15 defense with DoD, and I suppose even in health care we have
16 Phil Proger's and his clients, or Mr. Cubbin's, we have a
17 very sophisticated customer, generally.

18 Who do we turn to in your industry? Who helps us
19 make the assessment as to whether these innovation
20 efficiencies and benefits are desirable ones, let's say,
21 from a merger as opposed to keeping two research tracks or
22 two products going?

23 MR. MacLEOD: I think here, the ultimate consumer
24 has the sophistication, generally, that we need -- and
25 probably more than we need -- to ensure that the markets are

1 going to deliver the valuable innovations and are going to
2 penalize the frivolous innovations.

3 If there is a better way of making low-fat or
4 non-fat cookies, cakes, or bread or salad dressings, that is
5 an efficiency that is involved not only with delivering the
6 information to the consumer, getting the fat out of the
7 product, and keeping the taste in the product, it doesn't
8 require a very sophisticated bulk purchaser to tell us
9 whether or not that salad dressing, that cake, is going to
10 deliver far more benefits to consumers than what they would
11 have purchased otherwise.

12 Consumers can tell us that themselves. The
13 dynamic efficiencies are written all over the products.

14 They are, in part, expressions of what consumers
15 desire in products. When they're successful, they're
16 correct expressions. When they are failures, they are
17 incorrect expressions.

18 But that's something that consumers generally can
19 determine in consumer goods manufacturing.

20 CHAIRMAN PITOFSKY: Well, thank you very much.
21 Not only did we have a fascinating morning of discussion,
22 but we finished on time.

23 And I do really appreciate your coming, and we
24 look forward to your coming back in another guise on another
25 topic.

1 We'll adjourn and resume at 1:30.

2 Thank you.

3 (Whereupon, a luncheon recess was taken at 11:30
4 a.m. until 1:30 p.m.)

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1 Trade Commission.

2 Prior to joining the Commission, Terry was a
3 professor of law at Vanderbilt Law School where he taught
4 courses, surprisingly enough, on antitrust and trade
5 regulation.

6 Terry has also been very active in the ABA
7 Antitrust Section's Robinson-Patman Committee, the Noerr
8 Doctrine & State Action Committee, and the Special Committee
9 on Antitrust Penalties and Damages, and as a member of the
10 Governing Council.

11 Terry, thank you for coming.

12 MR. CALVANI: Thank you, Commissioner Starek,
13 members of the staff, ladies and gentlemen.

14 I'm delighted to appear before you here this
15 afternoon to address the subject of efficiencies and the
16 role they play in antitrust analysis.

17 But before specifically addressing that topic, I
18 want to take this opportunity to congratulate the Commission
19 on recent changes in the Commission's practice that makes
20 the Commission discharge of its own law enforcement mission
21 more efficient.

22 I refer firstly to the adoption of a sunset policy
23 for both competition and consumer production orders; second,
24 the announcement that the Commission will no longer
25 necessarily, routinely file administrative actions following

1 a failure to obtain injunctive relief in the federal courts;
2 and lastly, the suggestion that the Commission will no
3 longer routinely insist on prior approval provisions in all
4 merger orders.

5 I came to appreciate the significance of the
6 latter two policies only after returning to the private
7 practice of law.

8 These two policies, the prospect of administrative
9 litigation and the prior approval provision made it
10 important -- all other things being equal -- to secure a
11 merger review by the Antitrust Division of the Department of
12 Justice if possible. The costs and delay associated with
13 administrative litigation were such that very few companies
14 could afford to dispute with the Commission. And the very
15 nearly automatic filing of an administrative action when the
16 parties resisted the Commission in federal court made the
17 parties also reluctant to litigate in that forum, too.

18 The process effectively denied many their day in
19 court by insisting that they received years in court.

20 Automatic insistence on prior approval effectively
21 removed many companies from the marketplace and may have
22 impeded competition in some instances. I know of companies
23 that have failed to qualify as bidders because they were
24 under an FTC order.

25 The absence of HSR-like time constraints on

1 Commission action and the arbitrary and capricious standard
2 of judicial review made many sellers unwilling to admit a
3 buyer under order to their auction.

4 These two procedural aspects of Commission
5 practice made many prefer clearance to the Department of
6 Justice.

7 The issue of dual jurisdiction is an important
8 one, but one that I will not address today.

9 Nonetheless, dual jurisdiction is particularly
10 suspect where there is asymmetry in the regulatory costs and
11 where the clearance process may be outcome determinative.
12 That was not good government, and I congratulate you,
13 Commissioner Starek, and your colleagues on these very
14 important reforms.

15 Well, are efficiencies a legitimate object of
16 consideration?

17 The Commission first considered this issue in its
18 decision in American Medical International, where it
19 attempted to parse the law and suggested, albeit in dictum,
20 that efficiencies were a proper subject for Commission
21 consideration.

22 Having failed to find efficiencies there, the
23 Commission did not address the more interesting question of
24 what to do with them.

25 And I think it fair to say that Commission

1 guidance on this issue has not progressed much since 1984.
2 While Part 4 of the current Merger Guidelines recognizes
3 efficiencies as a legitimate object of consideration, they
4 provide very little further guidance.

5 Accordingly, I think it's appropriate that the
6 Commission consider this issue anew.

7 The contours of this debate have shifted somewhat
8 over time, and I think that's attributable in part to the
9 fact that consideration of efficiencies has, for a long
10 time, been a backhanded way of debating the competitive
11 effects of a transaction when the competitive effects story
12 played a less prominent role in merger evaluation.

13 The parties urged efficiencies as a way of saying
14 that the transaction did not pose any probable
15 anti-competitive effect.

16 But while the Supreme Court has not reconsidered
17 the concentration presumption espoused in cases like
18 Philadelphia National Bank, the antitrust agencies --
19 thankfully, I might add -- have embraced the need to tell
20 the competitive effect story in Part 2 of the Merger
21 Guidelines. Thus, much of the discussion of efficiencies in
22 the context of presumptively illegal mergers may not be as
23 relevant today as it once was.

24 Thus, for example, the example of a transaction in
25 a concentrated industry which posits no price increase and

1 efficiencies that are wholly passed on to consumers is of
2 less interest today than in an era when the concentration
3 presumption was king of the mountain.

4 Of some greater interest, consider a merger
5 between two small, inefficient companies in a highly
6 concentrated market where the industry price is fully rent
7 taking and set by a large, dominant competitor. Such a
8 merger may be efficient; and in that event, there will be a
9 net social gain. No additional wealth transfers will take
10 place, and resources will be saved.

11 The efficiencies defense might be appropriate in
12 this context. I hesitate and use the word "might" because I
13 would prefer to argue that the transaction is not likely to
14 lessen competition to begin with and resort to the
15 efficiencies defense is unnecessary.

16 I recognize, however, that the Commission may
17 disagree. And I note that the Commission has, within recent
18 memory, authorized the staff to seek a preliminary
19 injunction enjoining such a transaction where there was a
20 consensus on the Commission that the industry was fully
21 exploiting the industry monopoly price.

22 In that case, in that context, the efficiencies
23 ought to have been considered.

24 Of greater interest yet is the transaction where
25 there may be an increase in price and where none or only

1 some of the efficiencies are passed on to consumers.

2 I hesitate at this point because I fear that the
3 discussion takes on an unworldly aspect, an unworldly
4 appearance, an unworldly atmosphere, because in racking my
5 brain over my some seven years tenure here at the
6 Commission, I found it very difficult to identify cases
7 where that would be a fair characterization of the facts.

8 Nonetheless, there is substantial commentary and
9 support of efficiencies recognition in this context, and I
10 would join those in doing so personally because I find
11 triangles to be more interesting than rectangles.

12 But I've stated my views on the purpose of
13 antitrust elsewhere and will not tax this audience's
14 patience in that regard this afternoon. Rather, I leave the
15 Bork-Blake -- or more recently Elzinga/Sullivan -- debate to
16 others.

17 I would rather address the issue in the context of
18 those for whom allocative efficiency is but one of several
19 objectives.

20 I do so with some discomfort because I don't
21 belong in that charge.

22 Nonetheless, first, I suspect -- or while I
23 suspect that one can still demonstrate that the average net
24 worth of citizens is less than that of equity shareholders,
25 change in the demographics of shareholders have made the

1 redistributive consequences of antitrust policy less
2 important, even for those who embrace the Robin Hood School
3 of Antitrust. It would be interesting to see how the
4 presence of pension plans and eleemosynary institutions in
5 the market have changed the landscape. This may reduce the
6 importance of redistributive goals of antitrust policy for
7 those who embrace a social agenda.

8 Second, in this age of internationalization of
9 markets, domestic employment policy has a stake in the
10 success of domestic enterprise. These interests have a
11 stake in the ability of domestic organizations to succeed on
12 the field off world competition whether or not efficiencies
13 are passed on to consumers. And this is particularly true
14 in situations where efficiencies are treated more harshly
15 here than by antitrust enforcement agencies elsewhere.

16 Before concluding, permit me just a couple of
17 minor points. Indeed, I think I'll skip through a good
18 number of -- or at least part of this.

19 Let me just make a point on the debate on the
20 issue of whether a different standard of proof exists with
21 reference to efficiencies.

22 Spokespersons for the Department of Justice have
23 suggested that the requirement that efficiencies be
24 demonstrated by clear and convincing evidence was eliminated
25 in the Guidelines, while officials at the Commission

1 suggested otherwise.

2 Surely, the position of the Division is more
3 correct. The fundamental nature of a Section 7 inquiry is
4 speculative. What are the likely welfare consequences of a
5 transaction? And it seems to me at least, inappropriate for
6 the government to base its case on inferences largely taken
7 from market structure but require the parties to make a more
8 clear and convincing case on the efficiencies point.

9 Well, it's a bleak afternoon outside. People
10 probably find it difficult listening to me carry on anyway,
11 so I think I will stop here and toss the baton to you,
12 Mr. Commissioner.

13 COMMISSIONER STAREK: Well, thank you very much,
14 Terry. As always, it was extremely enlightening. And even
15 though it is a bleak afternoon outside, I found your
16 comments extremely interesting and very helpful.

17 Our next speaker this afternoon is Kevin O'Connor.
18 And Kevin is the Assistant Attorney General in charge of
19 antitrust enforcement in the Wisconsin Department of Justice
20 where he litigates criminal cases and large multi-state
21 civil antitrust cases on behalf of the State of Wisconsin.

22 Kevin serves as the current Chair of the
23 Multi-State Antitrust Task Force of the National Association
24 of Attorneys General. And he is in the business of
25 guideline authorship. He has co-authored a revision of

1 NAAG's Horizontal Merger Guidelines. And then in 1993 and
2 then in 1994, into this year, he also served as a co-author
3 of the revision of NAAG's Vertical Restraint Guidelines.

4 Kevin, thank you for coming.

5 MR. O'CONNOR: Thank you, Commissioner Starek.

6 I'm extremely pleased to be here as a
7 representative of the National Association of Attorneys
8 General.

9 I have to, first of all, give the disclaimer that
10 I always have to give that, even though I'm Chair of a
11 multi-state organization, I can't speak for anybody.

12 COMMISSIONER STAREK: We have those disclaimers,
13 too.

14 MR. O'CONNOR: With that said, let me continue.

15 The question today is whether the current
16 antitrust policy towards efficiencies is an appropriate one.

17 In order to frame the question properly, I think
18 we first have to understand what the policy is at the
19 federal and state level considering efficiencies and merger
20 analysis in particular.

21 And let me do a brief overview of what I
22 understand to be the federal policy as it is in the federal
23 guidelines, the DOJ-FTC Horizontal Merger Guidelines.

24 They seem to incorporate efficiencies in two
25 places, first in the general competitive effects section of

1 the merger analysis, in the five-part analysis; and then
2 later in the analysis, assuming that later portion of the
3 analysis is reached and the merger has not already been
4 screened out, efficiencies are dealt with separately and
5 explicitly in Section 4 of the federal guidelines.

6 Hence, even where concentration thresholds are
7 exceeded and a competitive effects story can be told, it
8 appears that the federal agencies, at least on the face of
9 the guidelines, will consider efficiencies where the merger
10 may be reasonably necessary to achieve sufficient net
11 efficiencies.

12 The federal guidelines seem to suggest that
13 efficiencies constitute a defense to a merger that would
14 otherwise be challenged if: one, efficiencies fall into
15 certain categories; two, the cost savings cannot be achieved
16 by the parties in any other way; and, three, that the net
17 efficiencies expected are greater than the anti-competitive
18 effects and risks identified in other sections of the
19 federal guidelines.

20 Also, consistent with the elimination of burdens
21 generally in the federal guidelines, the 1992 revision
22 eliminated the language that required the merging parties to
23 produce by clear and convincing evidence, evidence of the
24 efficiencies.

25 Although on the surface the federal agencies

1 appear to be attempting to operationalize the so-called
2 Williamson model for efficiency trade-offs, they don't say
3 so explicitly.

4 It is possible that the net efficiencies language
5 was meant to suggest that the federal agencies would not
6 consider, simply, small efficiency gains as a sufficient
7 offset to the high HHI's or changes in the HHI's.

8 In fact, subsequent cases seem to suggest a
9 reluctance by the federal agencies to dismiss the issue of
10 whether efficiency gains are passed on to consumers. And
11 I'm referring specifically to the Honickman case and others
12 like it.

13 Let me turn to the NAAG Guidelines.

14 Approximately a year after the federal agencies
15 revised their Merger Guidelines in 1992, the National
16 Association of Attorneys General adopted revised Horizontal
17 Merger Guidelines -- which, as Commissioner Starek has
18 pointed out, I was one of the principal co-authors of --
19 NAAG revised its guidelines in many respects.

20 In several respects, our guidelines converge with
21 those of the federal agencies. In particular in the market
22 definition area and in the section dealing with entry
23 analysis, we simply adopted the federal agencies' approach
24 either in total or at least as an alternative to our
25 approach. We were very persuaded -- we were persuaded that

1 their approach had a lot of merit.

2 However, because the federal guidelines did not
3 appear to articulate clearly the role and weight to be
4 assigned to efficiencies, the states were reluctant to adopt
5 that approach to efficiencies. Indeed, it seemed to many in
6 the states that the federal guidelines seemed to give too
7 much weight and credence to efficiency arguments in mergers
8 where those mergers were likely to reduce competition and,
9 hence, be of interest to antitrust enforcement agencies;
10 that is, those mergers that were in excess of HHI's of 1800,
11 where all the firms are equally sized, only five or six
12 firms in a particular market.

13 Briefly, the NAAG Guidelines -- taking that as a
14 departure point, the NAAG Guidelines started with the
15 assumption that when the Congress passed the Clayton Act,
16 they made it a basic presumption that, where there's more
17 competition in a market, there is likely to be more
18 efficiencies realized, technical efficiencies, or what
19 Liebenstein used to call x-efficiencies.

20 The NAAG Guidelines also state that there does not
21 appear to be any substantial empirical support for the
22 proposition that mergers that exceed the concentration
23 thresholds set forth elsewhere in the NAAG Guidelines:
24 "Usually -- and this is a quote: "Usually, or on average,
25 result in substantial efficiencies," unquote. That's what

1 our guidelines provided.

2 In addition, the NAAG Guidelines did five things.
3 I won't go through the entire statement of them, but I will
4 simply hit the highlights.

5 First and foremost, most mergers that come under
6 review by either the federal government or the states do not
7 involve any efficiency review, simply because they do not
8 exceed the concentration thresholds or because no
9 competitive effects story can be told or because entry looks
10 like it could be timely, likely, or sufficient to offset any
11 anti-competitive effects. The issue of efficiencies is not
12 reached in most cases.

13 Secondly, the states decided, for the reasons I'll
14 get into in a moment, to disavow expressing the efficiencies
15 issue as, quote, "defense," unquote.

16 Third, the states decided to preserve the clear
17 and convincing burden of proof on the merging parties simply
18 because they are the ones who are likely to be in possession
19 of that information and extraordinarily detailed information
20 that may be necessary to evaluate an efficiencies claim.

21 Fourth, our guidelines, quite frankly, express
22 skepticism about efficiencies, that efficiencies can be
23 proved in most cases.

24 Finally, we explicitly rejected the Williamson
25 trade-off model for evaluating efficiencies and adopted a

1 price model.

2 What's the rationale for this approach to
3 efficiencies? There are a number of reasons.

4 First, the states believe that redistributive
5 effects matter in merger analysis. We believe that an
6 analysis of the original legislative intent of the Clayton
7 Act Section 7 provides that. And I won't get into the legal
8 history or the statutory history here, but our guidelines do
9 cite some of that legislative history. And we believe that
10 that is something that cannot simply be disregarded.

11 That leads directly to the implication that the
12 Williamson trade-off model where allocative efficiency is
13 simply traded off against or measured against productive
14 efficiencies is not appropriate.

15 Moreover, when we were revising the NAAG
16 Guidelines in 1993, the states were aware and researched the
17 industrial organization literature as it related to the
18 likely effects of mergers in markets that could be
19 characterized as oligopolies.

20 Mergers in these types of markets are, by
21 assumption, the kinds of mergers that typically cause a
22 problem in terms of the concentration thresholds or raise
23 red flags that there could be a problem there, not that
24 there automatically is a problem but that there could be.

25 Typically, an industry characterized by an HHI in

1 excess of 1800 will have just a few firms possibly able to
2 exercise market power independently or, more likely, able to
3 affect price through tacit or express collusion.

4 Generalizing about oligopolies is always
5 difficult. However, even when one considers a wide range of
6 oligopoly models, which characterize these kinds of markets
7 where HHI thresholds are breached or exceeded, it appears
8 that efficiency gains would have to be fairly large to
9 offset the likely impact of mergers in concentrated markets
10 on allocative efficiency and price.

11 In a study expressly measuring the
12 price/efficiency trade-offs that occur in oligopoly markets
13 that are of most interest to antitrust enforcers, Fisher,
14 Johnson, and Lande concluded that the NAAG Guidelines most
15 appropriately matched up with the economic theory, the IO
16 literature, that tested the various models against the types
17 of efficiency gains that would have to be realized to
18 off-set the lost allocative efficiency and transfers.

19 I won't quote the entire article. In my paper, I
20 have a more extensive quotation. But in one small part,
21 Fisher, Lande, and Johnson concluded that the mergers that
22 resulted in much higher HHI levels or larger changes often
23 required extensive savings in marginal costs, frequently
24 much larger than one could expect from any merger, and
25 certainly larger than one could predict reliably in advance.

1 The NAAG Guidelines implicitly use the
2 concentration thresholds mentioned as benchmarks regarding
3 efficiencies. As we discussed the revision of our
4 guidelines, we asked the question: How likely is it that a
5 merger that's less than our guidelines is going to have
6 efficiencies -- a problem with efficiency?

7 And we concluded that, for the most part, we
8 wouldn't even reach that question because we would simply
9 pass on the merger so that that wasn't a concern. It was
10 those mergers that exceeded the guidelines, sometimes
11 substantially, where we would -- the issue might come up.
12 And we concluded that, based on research like Fisher,
13 Johnson, and Lande, that the efficiency gains in those cases
14 would have to be fairly large to offset the likely
15 anti-competitive effects.

16 In other words, our -- the concentration
17 thresholds implicitly include an assumption about
18 efficiencies.

19 Because of these concerns and because of the
20 concern about redistribution, the states explicitly adopted
21 a policy of efficiencies which incorporated the so-called
22 price standard for evaluating efficiency claims; that is,
23 where significant efficiencies are claimed, "The merging
24 parties -- and I'm quoting from the guidelines here: "The
25 merging parties must demonstrate that the efficiencies will

1 ensure that consumer prices will not increase despite any
2 increase in market power due to the merger," end of
3 quotation.

4 In other words, where concentration is high, the
5 NAAG Guidelines place the burden on the merging parties to
6 demonstrate claimed efficiencies, offsetting the impact of
7 the market power increase.

8 The NAAG Guidelines express -- contain a clear
9 presumption or statement that it's unlikely that this test
10 will be met in most cases. Thus, the 1993 revisions of the
11 NAAG Guidelines left the door slightly ajar for such a
12 showing, but they accurately indicate that, where
13 post-merger concentration figures are in excess of the
14 concentration thresholds, efficiency claims are likely to
15 be, at best, a tie breaker in very close cases.

16 Let me turn to another reason for our position on
17 efficiencies.

18 Efficiencies are often very difficult to measure
19 on a case-specific basis.

20 Notwithstanding this, the federal guidelines
21 appear to call for a case-by-case analysis of this and some
22 kind of a trade-off between efficiency and market power.

23 However, the states concluded, based on their
24 experience evaluating mergers, that such a detailed
25 case-by-case review is very difficult to do with precision,

1 given the difficulty of modeling the industry involved and
2 determining ex ante the cost savings that might accrue from
3 the merger.

4 Oftentimes, merging parties have provided little
5 more than ephemeral stories about possible efficiency gains.
6 The one that comes to mind, in my personal experience, is
7 the two hospitals that came in and, after a fairly long
8 meeting, started talking about efficiencies. And when asked
9 what they were, talked about the merging of their laundry
10 facilities. And that was it. And we quickly wrote that one
11 off as something they could do without having to merge. I
12 mean, it was obviously an efficiency they could gain in a
13 lot of other ways.

14 But even when the stories have more substance, one
15 encounters numerous theoretical and factual issues assessing
16 efficiencies, such as factoring in product heterogeneity,
17 allocating joint costs in a multi-product firm, measuring
18 changes in quality and variety, and a number of other
19 factors.

20 Moreover, the states were unable to find much
21 empirical work which allowed for accurate predictions about
22 characteristics of mergers. Indeed, the states' skepticism
23 about alleged synergies seemed to be warranted not only by
24 the states' concern with individual merger cases but also by
25 the academic literature.

1 And I'm referring back to the time when we were
2 doing the guidelines analysis looking -- I recall looking at
3 the Porter studies of corporate synergies, Michael Porter's
4 studies of corporate synergies, and being unable to find a
5 lot of convincing evidence that efficiencies were present in
6 many of these transactions.

7 In preparing for this hearing today, I attempted
8 to find the most recent studies that I could dealing with
9 synergies from recent corporate mergers; and the one that I
10 found that was most recent is a recent Business Week Mercer
11 Management Consultant study that basically concluded that
12 the synergies expected to be realized from any of these
13 larger deals in the early 1990s have yet to be realized.

14 And without quoting all of the excerpt that I put
15 in my paper, I should note that the analysis also concluded
16 -- and I'm quoting here: "...that most of the '90s deals
17 still haven't worked. Of the 150 recent deals valued at
18 \$500 million or more, about half destroyed shareholder
19 wealth, judged by stock performance in relation to the
20 Standard & Poor's industry indexes. Another third
21 contributed only marginally to it. Further, says James
22 Quella, director of Mercer Management Consulting, 'many
23 deals destroy a lot of value.' Mergers and acquisitions, he
24 declares, 'are still a slippery slope.'"

25 The NAAG Guidelines reflect the states' own sense

1 of fallibility in the efficiencies area, given the
2 difficulty of predicting efficiencies or the lack of
3 efficiencies and how such a finding would interact with
4 changes in market power caused by the proposed transaction.

5 That should not be read to suggest that the states
6 are hostile to efficiencies. I mean, we believe that
7 efficiencies are present in many deals. It's simply that
8 when you're establishing policy and benchmarks, one needs to
9 take into account the limitation of both the theory and the
10 data that might be available to apply that theory in
11 particular transactions.

12 And as we wrote the guidelines and tried to
13 formulate our policy towards this particular issue, we had
14 trouble coming up with a strong foundation on which to
15 present a policy that was more, shall we say,
16 "accommodating" of efficiencies.

17 Let me briefly address this issue of guidelines,
18 because that is where the policy of the agencies and the
19 states is generally ensconced.

20 A related reason for the NAAG approach to
21 efficiencies is that -- the reason enforcement agencies
22 adopt guidelines to begin with, is to give clear benchmarks
23 where benchmarks are possible of the type of cases that
24 would interest an enforcement agency.

25 In the exercise of prosecutorial discretion --

1 because that is what we do -- the antitrust enforcers ought
2 to bring to bear the most sophisticated IO economic theory
3 tools possible, provided there is data present to support
4 the application of the theory.

5 The FTC and USDOJ have demonstrated an
6 extraordinarily high level of sophistication in the merger
7 analysis and in the exercise of their prosecutorial
8 discretion.

9 However, where the theory and the related
10 empirical work are not sufficiently developed to extrapolate
11 the clear benchmarks, it is best not to suggest in
12 guidelines that every approach will or ought to be applied
13 with respect to mergers in general.

14 Guidelines which provide that everything is
15 relevant do not provide much guidance and may potentially
16 undercut enforcement, in my view.

17 For example, such guidelines may invite the courts
18 to attempt to engage in such sophisticated analysis or place
19 the burden for such analysis in a litigation setting on the
20 government, even though the merging parties are the ones in
21 possession of most of that information, and even though such
22 an undertaking is not likely to be done, in the words of
23 Richard Schmalensee who looked at this specific issue back
24 in the late '80s, "accurately, predictably, or quickly in
25 such a litigation setting."

1 Let me turn briefly to the issue of trade concerns
2 or export concerns.

3 Finally, it's been suggested that an efficiencies
4 defense ought to be invited where it can be shown that a
5 merger could enhance the ability of the merging entity to
6 compete in international trade even where it may raise
7 prices in domestic markets.

8 Obviously, if it didn't raise prices in domestic
9 markets and there was no market power problem, obviously,
10 this would not be a concern to antitrust enforcers. It's
11 only in the case where the exports are at the expense of
12 lost competition or the increased market power in the
13 domestic market that this becomes an issue.

14 The NAAG Guidelines do not establish
15 appropriately, in my view, a separate and distinct provision
16 for the situation. It does not seem to be wise policy to
17 permit mergers that raise prices in domestic markets to
18 subsidize, in effect, exports.

19 First, the trade-off of domestic consumer injury
20 against domestic job creation implicit in this analysis
21 would seem to rival the Williamson efficiency trade-off in
22 complexity.

23 Second, the redistribution of income from
24 consumers to exporters and their employees, presumably,
25 seems inconsistent with the goals of the Clayton Act.

1 And, finally, it would seem more appropriate to
2 deal with this situation by modifying market definition
3 methodology to take account -- if needed, to take account of
4 markets where foreign trade is likely to be an issue. In
5 other words, deal with it by defining the markets in a more
6 realistic and accurate way than simply allowing that kind of
7 a trade-off.

8 Let me turn briefly to a comment, and I won't go
9 through all of my statement on this; but I would be happy to
10 respond to questions about it.

11 Although the NAAG Guidelines discourage a
12 case-by-case approach to the balancing of provable
13 efficiencies against increased market power, the states
14 have, on occasion, carefully weighed claimed efficiencies
15 against anti-competitive effects of an acquisition and also
16 examined whether a less restrictive alternative, such as a
17 joint venture instead of a merger, could be fashioned to
18 achieve the efficiencies but avoid the anti-competitive
19 effects.

20 Also, in declining markets, the states have
21 formulated remedies to ensure that alleged cost savings are
22 passed on to consumers, especially where the transaction
23 results in only one or two competitors in a given market.

24 The two cases cited in my remarks deal with the
25 Williamsport Hospital case and the Morton Plant Health

1 Systems case, both of which were state cases. And in the
2 latter case, was a case brought by the State of Florida with
3 the -- and the U.S. Department of Justice, jointly.

4 In the Pennsylvania case, the Pennsylvania AG
5 negotiated a consent judgment which provided that the
6 merging hospitals, three of the four hospitals in Lycoming
7 County in north central Pennsylvania would be allowed to
8 merge on the condition that their claimed efficiencies of
9 \$40 million over the five years would be passed on to
10 consumers in certain specified ways.

11 The consent judgment then went on that, if those
12 provable cost savings were not passed on, the parties would
13 have to pay to the Pennsylvania Attorney General's office
14 the difference between what they could prove that was passed
15 on and what they had claimed at the outset. And then the
16 Pennsylvania AG's office would then distribute that money to
17 the benefit of the consumers who may have been -- who had
18 not realized those efficiencies.

19 In the Morton Plant Health Systems case, the
20 proposed merger was not allowed simply because the USDOJ and
21 the Florida Attorney General's office concluded that most of
22 the efficiencies that had been claimed could be achieved --
23 if they could be obtained at all, could be obtained through
24 a consolidation of certain types of services without an
25 outright merger of the two entities.

1 Now, the remedies that I just described were not
2 explicitly contemplated by the NAAG Guidelines when we
3 re-drafted them in 1992. Such an approach, however, is
4 consistent with the observation of Areeda and Turner that
5 such efficiencies -- such an efficiencies defense should be
6 permitted where an industry is declining.

7 Where market demand is increasing, internal
8 expansion usually offers a viable alternative to a merger as
9 a way to realize efficiencies.

10 Similarly, the Morton Plant settlement underscores
11 the states' reluctance to accept a merger if an alternative
12 to outright merger can be crafted which will achieve the
13 claimed efficiencies.

14 Simply put, it remains to be seen whether these
15 kinds of conduct-oriented injunction provisions can
16 accommodate -- can be administered effectively.

17 I know that some have suggested that, as an
18 alternative remedy, that mergers ought to be permitted
19 subject to being unraveled several years later if the
20 claimed efficiencies were not realized.

21 And that situation seemed to pose the problem of
22 the proverbial unscrambling of the egg. Whereas these
23 remedies, I think, hold out the promise that perhaps they
24 won't require a massive review later on but simply some sort
25 of a clear analysis -- a clear-cut analysis at the end of

1 the day.

2 However, it remains to be seen whether this is
3 going to be an effective way to deal with the issue of
4 efficiencies.

5 Having said that, I think I will stop there.

6 COMMISSIONER STAREK: Well, thank you. Very
7 interesting. I wonder how that conduct remedy deals with
8 the cost of health care to consumers.

9 But, anyway, I think what I heard in your
10 statement is that we now have two votes for the
11 interpretation that clear and convincing evidence was
12 eliminated from the guidelines. So I think you agreed with
13 the previous speaker on that.

14 I will be interested in the discussion period to
15 hear our two speakers who have gone so far discuss the
16 redistributive effects and the importance of that. I think
17 that sets up an interesting discussion.

18 Shall we move on to academia?

19 Our first professor this afternoon is another
20 returning alumnus. Tim Muris is the George Mason University
21 Foundation Professor of Law, George Mason University.

22 And before he joined the law school faculty at
23 George Mason in 1988, Tim served as the Executive Associate
24 Director -- one of the Executive Associate Directors in the
25 Office of Management and Budget.

1 And before going to OMB, he worked here, first as
2 the Director of both the Bureaus, the Bureau of Consumer
3 Protection, from '81 to '83, and the Bureau of Competition
4 from 1983 to 1985.

5 Tim also serves as a Senior Fellow at the Progress
6 and Freedom Foundation. He is the Coordinator of the
7 regulatory law track at the George Mason School of Law and
8 is an adjunct scholar at the American Enterprise Institute.

9 Tim, welcome back. Thank you for coming.

10 MR. MURIS: Thank you, Commissioner Starek. It's
11 certainly a pleasure to be back in Room 432. In fact, it
12 was 21 years ago this month I had the first matter that I
13 dealt with as a staff member before the Commission; and I've
14 seen several configurations of the table in the room here.
15 So it's interesting to see another one.

16 COMMISSIONER STAREK: Yeah, this is a new one,
17 isn't it.

18 MR. MURIS: Yeah. I don't know if it's true that
19 the difference between republican and democratic chairs was
20 that the republican had a bigger chair than -- does Chairman
21 Pitofsky use a regular chair? The same as everyone else?

22 COMMISSIONER STAREK: Absolutely. But he does
23 like to sit sometimes at the end of the table as opposed to
24 the middle.

25 MR. MURIS: Yeah, that was a -- that was a

1 configuration once, too, with the chairman at the end.

2 I spent a lot of time over the years on this
3 efficiency issue, and I think it's important to understand
4 that if anything comes out of what the Commission is going
5 to do, I suspect it will be something like guidelines.

6 And hearing what the discussion of what guidelines
7 should do, I'm reminded of the scene in the first
8 Ghostbusters movie where Sigourney Weaver, possessed by some
9 demon, comes on to Bill Murray; and Bill Murray says: "I
10 have a rule against being involved with clients." And after
11 further events he says: "Well, it's not really a rule.
12 It's more of a guideline."

13 So I think whatever comes out of this, there will
14 be -- if the Commission does -- which I hopes it does --
15 issue some statement on the role of efficiencies, there will
16 be some ambiguity.

17 It's clear that over the years, the government has
18 been hostile to efficiencies defenses. And I -- although, I
19 don't mean to limit what I have to say to mergers, most of
20 the arguments have been in the merger context, so I'll focus
21 on mergers.

22 And I think it's time for the government to
23 re-evaluate the efficiency arguments and to approach
24 efficiency without undue skepticism.

25 And let me focus on three issues that are

1 frequently raised as standards that I think are part of that
2 undue hostility.

3 The first is the so-called "pass-on defense." I
4 think where that comes from -- it comes out of the academic
5 debate about the so-called Williamson issue and whether we
6 ought to have consumer standard, price standard, or an
7 allocative efficiency standard.

8 Although I think that's an interesting issue --
9 and I've written about it myself -- I think it illustrates a
10 typical academic tendency to focus on interesting issues
11 that are empirically relatively trivial, because the truth
12 is that there are few cases that, in my experience as Bureau
13 Director, in following mergers that both raise -- where
14 you're talking both about a price increase and a reduction,
15 in fact, if the government had the burden to show, even in a
16 likely sense that price would rise in a typical merger
17 transaction, it couldn't meet that burden.

18 Instead, the government bases a presumption of
19 anti-competitive effect using concentration thresholds and
20 usually belief that entry is difficult; but the empirical
21 work provides at best -- and really at best -- only a weak
22 basis for that presumption.

23 To the extent that the current research -- if you
24 were looking for a consensus in the current research -- to
25 the extent it supports any thresholds, you would have to

1 have considerably higher concentration than the so-called
2 "highly concentrated" now; and it would have to involve the
3 leading firms.

4 Now, I don't object, given the prophylactic nature
5 of Section 7, to allowing a weak presumption to prevent a
6 merger absent efficiency evidence. But if you do have
7 likely evidence of efficiency, then what the pass-on test
8 does, it presents an additional hurdle to the merger when no
9 obstacle is justified, even -- and I think this is true --
10 if we accept the pass-on standard. Because what the pass-on
11 requirement is it's a clever method to require the merging
12 parties to show that the merger will not increase prices,
13 because the theoretical justification for that standard is
14 to ensure that the merger will not, in fact, result in an
15 increase in price.

16 And so what that standard effectively does is turn
17 what should be a weak presumption, in the typical case, into
18 a strong one.

19 So I think that requirement ought to be
20 eliminated, and it ought to be eliminated even if you
21 believe in a so-called consumer standard.

22 The second issue -- and like Commissioner Calvani,
23 I'll try to be brief.

24 The second issue is: What types of cognizable
25 efficiencies ought to be recognized?

1 And here again, the agencies have -- particularly
2 at the staff level -- have fought broadening an efficiency
3 defense. The guidelines talk about production efficiencies,
4 transportation efficiencies, give some grudging recognition
5 to administrative expenses.

6 But I think the empirical literature shows there
7 are other types of efficiencies and practical experiences in
8 cases that ought to be recognized. And let me just list a
9 couple.

10 Capital raising efficiencies. It's clear that
11 they are one of the most persistent advantages of corporate
12 size. I cite in my testimony some estimates. In a world of
13 positive transaction costs, which is the world that we live
14 in, I think that sort of advantage is inevitable.

15 Second, are promotional economies. I know Bill
16 MacLeod discussed the strange ambiguity towards those
17 economies that's exhibited by those who oppose recognition
18 of those economies.

19 The Commission has a long and proud history, going
20 back to when Bob Pitofsky was Director of the Bureau of
21 Consumer Protection, of striking down barriers to promotion
22 and recognizing the importance of promotion.

23 One of the things that then BCP Director Pitofsky
24 did was get the networks to drop bans on comparative
25 advertising.

1 The work of George Stigler and many others has
2 convinced economists and the Commission that barriers to
3 advertising and promotion ought to be struck down.

4 And I think that's one of the most bipartisanly
5 consistent and best aspects of the Commission's enforcement,
6 again going back into the early '70s.

7 Yet, when it comes to an efficiencies defense,
8 there's some unwillingness to say: Well, but that's
9 different; that's on a different level than other types of
10 efficiencies. I don't think that should be the case.

11 Managerial economies I also think are very
12 important. I was the Director of the Bureau of Competition
13 when Terry Calvani was in the Commission majority when the
14 General Motors/Toyota joint venture was approved.

15 One of the reasons it was approved was because of
16 a chance to apply what was felt to be and I think has been
17 shown to be superior Japanese management techniques.

18 More recently, ADM acquired Clinton Corn
19 Processing. And during the Reagan administration, the
20 Antitrust Division vigorously fought that merger and tried
21 to throw every obstacle it could in front of an efficiency
22 defense.

23 But one of the government's own witnesses when
24 asked, if you could pick one company to do the most good for
25 Clinton, what would that company be? And the witness said:

1 ADM.

2 Now, part of what's going on here is sort of hard
3 to separate managerial from production techniques from other
4 kinds of efficiency. But if you say managerial doesn't
5 count, then you get into that strange box that the
6 government tried to get itself into in the ADM case.

7 The government lost the ADM case, but the judge
8 didn't feel that he had to -- in his opinion, get into the
9 efficiency issues.

10 The last issue I wanted to discuss is this
11 question about whether efficiencies have to be unique to the
12 transaction, which is sometimes thrown up as a standard.
13 And I disagree with that standard because it's one of
14 capability or feasibility and not one of cost benefit, when
15 cost benefit is what Section 7 is all about.

16 The focus should not be on whether one method --
17 another method exists to obtain lower costs but whether --
18 but comparing the two methods in terms of their cost to the
19 two methods and the relative speed of implementation of the
20 two alternatives.

21 The mere possibility that cost savings could be
22 achieved through an alternative means is not the right
23 issue. In particular, internal expansion -- which is
24 frequently said, well, let them expand internally -- is
25 unlikely to occur in certain cases.

1 Indeed, one of the benefits of the new guidelines
2 was recognizing what additional capacity could do to a
3 market in terms of focusing on entry. Additional capacity
4 might drive down price and create a disincentive to make
5 such an investment in the first place. And that's found to
6 be relevant in the entry context. And it certainly ought to
7 be relevant in the efficiency context in talking about the
8 relative attractiveness of internal expansion.

9 I think the Supreme Court in GTE/Sylvania, when it
10 said that antitrust law shouldn't channel transactions into
11 one form or another, that that's unlikely to further
12 significant social goals. I think that's something we ought
13 to remember in the efficiency context.

14 Well, here we are in 1995 where most people -- I
15 think the debates of the '60s where efficiency was thought
16 to be a reason to strike down mergers -- I mean, we have
17 moved beyond that. It would seem to me axiomatic that
18 merger laws should be interpreted to realize the further
19 realization of such efficiencies. The government,
20 unfortunately, still presents obstacles to an efficiencies
21 defense. And I think that it's time to end this last
22 vestige of the bygone era of antitrust law when the law too
23 often serves competitors and not competition.

24 Thank you.

25 COMMISSIONER STAREK: Thank you, Tim. Very

1 helpful. Appreciate it very much.

2 Well, it looks like we're going to have an
3 interesting and lively debate here after the break.

4 But before the break, we need to move on to our
5 final speaker this afternoon who is Joseph Brodley.

6 Professor Brodley is a Senior Associate Dean for
7 Research, Professor of Law and Economics and Kenison
8 Distinguished Scholar of Law at Boston University.

9 Also, from the 1989 to 1990, Professor Brodley
10 served as the Dean ad interim of the Boston University Law
11 School.

12 Professor Brodley has served as a consultant to
13 the Antitrust Division of the Department. And from 1992 to
14 1993, he served as a consultant to the United Nations
15 Development Project, People's Republic of China on issues
16 relating to drafting their competition laws.

17 Professor Brodley, thank you for coming.

18 MR. BRODLEY: Thank you, Commissioner Starek.

19 I'm going to focus my remarks on the issue of how
20 can we best make an efficiencies defense operational?

21 Thus, I'll assume that it would be desirable to
22 have an efficiencies defense and try to set up -- or state
23 the framework of such a defense, focusing on how actually to
24 try to use these tests that could be applied.

25 It seems to me the essential structure of an

1 efficiencies defense must involve a two-stage proceeding, an
2 ante review to identify cases where efficiencies are
3 plausible; and an ex post verification that efficiencies
4 have been realized.

5 I think there are many advantages in such an
6 approach. It substitutes for what are now often extravagant
7 but more importantly difficult to assess advance claims the
8 actual test as to whether efficiencies have been realized.
9 Of course, no test such as this will be perfect, but it is a
10 lot better to do so before the fact.

11 Such an approach is information-conserving; that
12 is to say, it allows the agency to use an over-inclusive
13 approach at the ante stage when information is scarce
14 because later when information is more plentiful, it can
15 correct any overextension.

16 It also serves as a separating mechanism in the
17 sense that parties, knowing that their claims will be
18 subject to review, will rationally desist in making claims
19 that they don't feel they could later verify.

20 The essential framework of this would include, I
21 think -- and I agree, I think, in substantial part with Tim
22 Muris -- all types of productive and innovation economies --
23 not necessarily everyone he mentioned; but in general, I
24 think he has expressed himself that way in the past -- I
25 would not require pass on for the reasons that, I guess, he

1 and Terry Calvani stated; but I think also for two other
2 reasons.

3 One, I think the conditions for screening such an
4 efficiencies approach at the ex ante stage can provide for
5 some eventual pass on by structuring relationships --
6 restraints so that they are not perpetual.

7 And second, because when we are talking about
8 productive and innovation efficiencies, these have effects
9 on other parts of the economy; and even from the consumer
10 standpoint may actually create more wealth than would be
11 harmed by a deferred failure to pass on efficiencies.

12 The interim period, I would suggest, it would be
13 from three to five years between the ex ante and ex post.

14 And finally, such a proceeding would be based on
15 the consent of the parties who would agree to it and would
16 agree to accept a remedy which ideally should be specified
17 in advance and I think I would go farther and ask them --
18 parties to actually suggest the remedy they think would be
19 adequate. They wouldn't necessarily get that remedy.

20 Now, turning to the two proceedings, the ex ante
21 procedure is designed to screen the proposed collaboration,
22 meaning either a merger or a joint venture. So some
23 standard has to be established for that.

24 And I think the -- a showing -- a prima facie
25 showing, not a conclusive showing that this transaction is

1 likely to produce efficiencies of 5 percent or greater would
2 be a good benchmark.

3 Secondly, the ex ante proceeding should eliminate
4 high competitive risk cases. In the recognition of
5 economies area, and referring specifically to mergers, I
6 think a good cutoff as any is that that's been proposed by
7 the Chairman before he became Chairman, the 35 percent
8 market share or 1800 HHI; albeit, that won't save too many
9 mergers, since most mergers below that amount aren't in
10 trouble, as I understand it.

11 But clearly that approach, to my mind, should not
12 apply to joint ventures. A higher limit is needed for them
13 because of the lesser nature of the restraint; and clearly,
14 it won't apply -- shouldn't apply to innovation joint
15 ventures -- or innovation collaboration.

16 Innovation collaboration, I think the standard or
17 cutoff should be either single firm dominance or less than 4
18 R&D centers, actual or highly potential, something along
19 those lines.

20 The prima facie proof, what would that consist of?
21 Well, it first, I think, would consist of the parties' own
22 plans and, even better, engineering studies indicating that
23 these efficiencies are promising.

24 Second, it could consist of past experience in the
25 industry or comparable industries of similar mergers or

1 joint ventures.

2 Third, if available cross-industry studies would
3 be useful.

4 And fourth, of more limited use but still of some
5 use, would be a stock market study showing how the market
6 anticipated the increase in value following the announcement
7 of the merger. Only a prima facie showing, though.

8 A less restrictive alternative I think is an
9 important condition, but it shouldn't be extended in the
10 ways that Tim was suggesting. I think, it would simply mean
11 that any other alternative, which is suggested, would
12 involve significantly higher costs relative to the
13 efficiency gain.

14 So if the efficiencies -- well, I think that's
15 clear. I won't explain it.

16 Now, turning to the ex post proceedings, other
17 parties are free for a period of three to five years,
18 depending on the nature of the case.

19 The issue at the ex post proceeding, essentially,
20 I think should be, have the costs of these merging or joint
21 venturing firms fallen relative to rivals? It's not enough
22 if their costs fall over time, because the costs of firms
23 generally fall over time.

24 Now, breaking that issue down, let's first look at
25 plant level economies.

1 Here -- and I want to bear down on how this is
2 going to be proved, or how I suggest it could be proved.

3 At the plant level, the data could be pretty good.
4 Engineering studies are available, which are expensive but
5 quite effective, and statistical cost analysis is also
6 available because there are sufficient observation points
7 when you get to plants to actually make such studies.

8 There are other tests that could be used and they
9 would be admissible of course, but I think those tests could
10 be the primary approaches and could be effective.

11 The problem is that the impact -- the social
12 impact of this is limited because, as I read the literature,
13 most plant scale economies are realized at pretty small
14 market shares. So it's worth doing, of course; but if we're
15 going to make an impact, we have to get to the firm level.
16 And there it gets much more sticky with respect to tests.

17 And what I would like to suggest for your
18 consideration is a multiple test approach. And the multiple
19 test would be broken down into sort of three kinds of tests:
20 First, input based tests which provide a screen, an initial
21 screen, as I'm going to suggest; second, comparative tests
22 which will test how this collaboration compares with what's
23 going on elsewhere in the industry; and third, confirming
24 tests.

25 Okay. Looking at the first, input based tests,

1 the input based tests are very limited because, in some
2 ways, if you say this is -- if you do these things, apply
3 these R&D resources, you pass the efficiency test. Of
4 course, all effort focuses on the inputs, not the results.

5 But nevertheless, it may be clear that certain
6 inputs are necessary -- not necessarily sufficient -- to get
7 an efficiency result.

8 If that's so, then those could be initial hurdles
9 which would be necessary for the parties to confront.

10 For instance, if two hospitals, say they are going
11 to, in effect, consolidate their operations and they don't
12 consolidate, then they haven't met this ex ante condition
13 and would have failed at the first stage.

14 Second, comparative tests are needed. And this is
15 where it's necessary to get beyond the engineering studies
16 and statistical cost analysis which aren't as effective in
17 terms of comparing one firm with another. They can tell you
18 what's going on within a firm. But to actually make this
19 comparison, it would be extraordinarily difficult and the
20 data often not available.

21 Here, I'd rely, first, on the survivor test; and
22 not as a sole test but as one among several tests.

23 Basically -- it's hard to explain this very
24 quickly, but basically the survivor test simply asks whether
25 a firm has grown relative to its rivals?

1 Actually, the survivor test asks, in economics,
2 whether the firm has survived in the market; so I'm pushing
3 it a step further. Whether the firm has grown, has proved
4 through the market that it has superior qualities over time.

5 Now, to the extent -- that test has some problems
6 in it, to be sure. To the extent that test is doable, it
7 fits very good in the legal process. It's something that an
8 agency could apply. It's something the courts find
9 congenial. They use that type of analysis already in cases
10 such as BMI and Aspen have aspects of this. And it has some
11 drawbacks, to be sure. But as I specify in at length in my
12 paper, I think all of these drawbacks are manageable.

13 It's over-inclusive; but that's okay, too, because
14 other tests will be applied as well. And I think it,
15 therefore, is a very effective test within the group of
16 tests.

17 A further test that could be applied is a stock
18 market test, although now made more difficult because we
19 were talking about stock market values over a period of
20 years; and there's an awful lot of noise in that sort of
21 thing.

22 Nevertheless, you would expect that if the
23 efficiencies have been realized that the stock market values
24 would increase, provided that you can actually compare the
25 firms. Of course, if it's just one division of a firm,

1 stock market won't be very useful.

2 Other tests are not very effective, but one that
3 might be different is, if particular assets that are -- as
4 to which the efficiencies were claimed have been sold off in
5 the market, that might provide -- for instance, in the
6 credit card field, credit card assets when sold off command
7 values three times the value of other banking assets.
8 That's some sign that there's profitability in such assets.

9 Now, of course, profit doesn't equal efficiency.
10 Profit could be gained through cartelization, through
11 pecuniary economies and so forth. So some confirming test
12 needs to be applied to try to connect this with real
13 efficiencies.

14 And here's where we can go back and, I think, use
15 the engineering studies and statistical cost analysis but at
16 the firm level. You then ask whether this firm has
17 increased its own efficiency as significantly. And these
18 studies could actually, plausibly, reasonably effectively,
19 identify whether, within the firm, efficiencies have been
20 obtained.

21 So, if you find that comparatively it's done well
22 on tests which are admittedly over-inclusive but then
23 confirmed by showing that historically, within the firm,
24 it's doing well. Indeed, even a profit test might not be
25 out of the question because firms are not free to simply

1 change accounting standards willy-nilly. So on their
2 accounting standards if significant improvements are seen,
3 that might help. Again, none of -- no one of these can be
4 sufficient. They'd have to be put together as a group.

5 Well, I'll just say a couple of more things
6 because I've used up my 15 minutes. But if I could just
7 take another minute or two, I would like to.

8 Should interim anti-competitive effects be
9 admissible at the second proceeding? Objection, of course,
10 that they shouldn't be because you're re-litigating the
11 case; and that shouldn't be.

12 But it seems to me that -- and it should be
13 relevant if, with respect to the very calculation that's
14 involved, anti-competitive effects have emerged.

15 On the other hand, as in the General Motors/Toyota
16 case, if it's shown that restraints are no longer a real
17 concern, that should be free to be considered, too.

18 The burden of proof on the ex ante proceeding
19 should be on the parties to show that the efficiencies have
20 been realized but on the Commission to show if, in fact,
21 there are any anti-competitive effects emanating from the
22 approved collaboration.

23 A final consideration I would like to suggest to
24 you is that these policies, if viewed favorably, can be
25 adopted incrementally.

1 First of all, the case -- the FTC can be extremely
2 selective in the cases in which it applies this.

3 Second, it can adjust its approach to the type of
4 efficiencies. If it thinks plant efficiencies are the most
5 salient, it could admit more of those cases. If they find
6 more of them where it makes a difference, they can utilize
7 the defense less frequently for firm productive economies
8 and firm innovation economies.

9 However, I think they -- and I guess my final
10 point is, I don't think it would be wise to just limit it to
11 plant economies initially, because it's inevitable that
12 cases are going to come along where large claims are made at
13 the productive and innovation level; and the economies are
14 going to have to be dealt with, of course, not necessarily
15 by this approach. But it would be valuable to start on a
16 very -- on some basis, applying the two-stage ex ante, ex
17 post approach in the productive and innovation level where,
18 I would suggest, the economies to be gained are so much
19 larger.

20 COMMISSIONER STEIGER: Professor, one question, if
21 I may, although, it's got a couple of parts, your suggestion
22 that -- your regime, if I may, could be applied selectively
23 at the discretion of the agencies is a very interesting one.

24 How would you counter criticism, should they
25 arise, that this was uneven enforcement and somewhat

1 quixotic, that this option was not extended to all
2 industries?

3 And the second potential criticism would be
4 uncertainty for industry, that they would have to live
5 through a defined period of time, presumably looking at us
6 over their shoulder, and not knowing the end result, that
7 this could be wasteful, so to speak, of innovation efforts.

8 They may not be real criticisms, but I suspect we
9 would hear them.

10 MR. BRODLEY: Well, no, no. I agree, they're real
11 criticism.

12 Well, as to the first question, that it wouldn't
13 be applied to all industries, I mean, I think it would be
14 applied to all industries; but what you mean, if you only
15 take a few cases, you won't be applying it to everybody. So
16 put it that way.

17 Well, the cases that you would apply it to would
18 be those where you find the efficiency claims are largest.
19 So you would be applying it to those where the efficiencies
20 are the greatest.

21 I mean, there's always going to be -- whatever you
22 do, there's going to be judgment in which cases, in a sense,
23 pass the ex ante screen.

24 In other words, it's how you -- at the ex ante
25 stage, what do you set the ex ante level at? Well, the

1 words would be "substantial" efficiencies. But if you find
2 that, for instance, innovation efficiencies are more
3 problematic to predict, then your substantiality level would
4 justifiably be high at that level.

5 I think the differentiation might be between types
6 of efficiencies in the sense that you would order the
7 efficiencies. If you found plant level the most solid, then
8 the degree of conviction -- or the degree of evidence that
9 might have to be shown there might not, say, have to be as
10 powerful -- or let's say overwhelming. If you find the
11 production to be less and innovation to be even less in
12 terms of the difficulty of proof, it seems to me, you simply
13 differentiate that based on the parties' ability to prove
14 them.

15 But I think it would be even handed as to type of
16 efficiency, to summarize that. And your judgment on the
17 type of efficiencies would be your view as to how difficult
18 they are to prove.

19 I don't think you need to take that approach. I'm
20 suggesting, I think that's an option you could take. You
21 could decide not to qualify your approach to any of them.
22 Indeed, I might do that if I were making the decision. But
23 I'm just suggesting an option would be to order your
24 thoughts that way.

25 As to the second question, as to the uncertainty,

1 I think that that falls into place when one realizes that
2 this procedure takes no right from any party that they now
3 have. No party need submit itself to this procedure. It
4 can go through the normal type of review where it can
5 present its efficiencies, as it now does; and the Commission
6 will recognize it or not recognize it. It can utilize all
7 those rights.

8 This represents an option that they don't have,
9 and it's an option that any firm could seek to do. And if
10 it they don't like the conditions that the Commission wants
11 to put on it, that is to say the kind of relief they expect
12 if doesn't go through, they could say: Well, gee, we prefer
13 not to do a two stage; we'll just present this as it is for
14 the normal examination. They won't have lost anything.
15 They will be presenting the same efficiencies in either
16 case. And then they can avoid this uncertainty.

17 So it's only -- and, finally, it's only as to a
18 transaction that you would have opposed in the absence of an
19 efficiencies defense.

20 So you give them an option they don't have. And
21 that, it seems to me, places them in a better position, not
22 a worse.

23 COMMISSIONER STAREK: Thank you, Professor. Thank
24 you for a very detailed explanation of a very interesting
25 approach to measuring and analyzing efficiencies.

1 I would like to point out that we're fortunate
2 today to have Dr. Roberts from our Bureau of Economics who
3 also has recently expounded, at some length, on very
4 interesting ways to look at and measure innovation
5 efficiencies that result from certain transactions. So I
6 will enjoy the discussion after our break between the two of
7 you.

8 I would like to, just before -- we need to give
9 our reporter a rest. But I would like to say that I think
10 the one thing we all seem to agree on is that -- and there's
11 not much, but there is one thing -- and that is that in some
12 transactions, efficiencies are produced.

13 And the problem that we face, and that you have
14 been addressing today is: When are these efficiencies
15 produced? And how are these efficiencies measured? And how
16 are these efficiencies to be analyzed? Are they part of a
17 competitive effects analysis? Or are they a defense to the
18 prima facie case?

19 So I would like to concentrate on that.

20 And the other thing I would like to concentrate on
21 this afternoon was a scenario -- or not a scenario, but a
22 description by one of our previous witnesses who is an
23 active practitioner before the enforcement agencies.

24 And he basically said that it's his experience and
25 a lot of other practitioners' experience that, when they

1 come to the agencies and they begin to talk about
2 efficiencies, the first thing they hear is: Oh, well, those
3 aren't cognizable; and they're really difficult to measure.

4 And then if they get past that hurdle, the next
5 thing is: Well, those aren't merger-specific. Some of the
6 points that Professor Muris raised.

7 And then, finally, the agencies will go: Well,
8 yeah, maybe they're merger-specific; but, you know, they're
9 not going to be passed on to consumers.

10 So I -- and as I said, Professor Muris addressed
11 this; and I'd like all of us, after a 10-minute break, to
12 take up these points.

13 Thank you.

14 (Recess.)

15 COMMISSIONER STAREK: Okay. I think we're ready
16 to reconvene. I think Commissioner Steiger will be
17 rejoining us shortly, but I think we ought to move on.

18 So let's take up a couple of the points that I
19 raised right at the conclusion of the first part of this
20 session.

21 Let's say that we have a transaction, maybe a
22 merger, where it looks like it's likely that there's going
23 to be an anti-competitive effect here, that output is going
24 to decrease or there is going to be a 5 percent or more rise
25 in price.

1 How is it, then -- but the parties are arguing
2 that we have substantial efficiencies.

3 How are we, how are the enforcement agencies
4 supposed to analyze this? Are we supposed to analyze the
5 efficiencies as part of the competitive effects analysis?
6 Or are we supposed to analyze this as a defense to the prima
7 facie case?

8 Any takers initially here?

9 Tim?

10 MR. MURIS: Well, I understand that in previous
11 panels, there's been some suggestion of looking at it in
12 terms of the competitive effects; but that doesn't seem to
13 be particularly logical at all.

14 There would seem to be no need to get into
15 justifications unless you think you've got a problem in the
16 first place; and, so, therefore, you ought to look to see if
17 you've got a problem. If you've got a problem, then you
18 look to see if there's something on the other side.

19 I mean, it seems to me to be as simple as that.

20 MR. ROBERTS: I guess I'm a little surprised, just
21 to follow up on that, in that one view that you hear
22 expressed -- and I'd like your comments on it -- is that a
23 problem with doing efficiency analysis only in the second
24 stage, only after you have decided that there are
25 significant potential anti-competitive effects, is that it

1 imbalances the analysis in that -- for instance, I think
2 Kevin Arquit, among others, has suggested that, perhaps, we
3 ought to look at efficiencies more in the initial evaluation
4 of a merger in trying to determine whether it's primarily
5 efficiencies versus market power implication that is driving
6 the transaction, in the first place.

7 Do you feel that that's a viable alternative and
8 that that has --

9 MR. MURIS: Well, look, if what you're talking
10 about is what happens at the staff levels, theoretically,
11 big underline, theoretically, the staff is supposed to
12 present the Commission with -- you know, having been here, I
13 know this doesn't always work that way in practice -- you
14 know, with as unbiased a view as possible of as many issues
15 as possible.

16 And now that, given that people are people, is not
17 -- you know, doesn't work 100 percent well. But I think,
18 for the most part, when I was here, the staff at least
19 tried.

20 And in that context, I think the staff ought to --
21 if it thinks it's a -- you know, if it thinks it's a close
22 case ought to try to take a look at efficiencies.

23 But even at the initial level, it seems to me the
24 staff is going to make some cut. And the first cut is going
25 to be, at least in its mind, on some idea of

1 anti-competitive effects, isn't it?

2 And if they don't think there are anti-competitive
3 effects, isn't it going to be over.

4 MS. DeSANTI: I guess, I thought that Commissioner
5 Starek was asking a really important, more fundamental
6 question. And I might think about it in the context of two
7 possible scenarios. And let me lay them out, and one I'm
8 going to crib from Terry Calvani, which is his short example
9 in his testimony of imaging that you have a market where
10 there are three or four firms but you've really got one
11 predominant producer with 70 percent of the market who's
12 setting the price and the others are price takers.

13 If Number 3 and 4 get together, is there any
14 anti-competitive effect that comes about through that, is
15 one of the questions raised in his testimony?

16 And should we think about it, then, in a sense, do
17 you need to get to cost reductions and efficiencies in order
18 to answer that question? So that's one example that I would
19 like to have people speak to in terms of whether they think
20 that efficiencies are relevant in that context.

21 The second is a case in which you have an
22 anti-competitive effect; but under some assumptions, which
23 Kevin O'Connor may not agree with, having to do with the
24 Williamson model, if there are going to be large cost
25 reductions, then there is, in certain circumstances, a

1 substantial likelihood that those cost reductions will be
2 passed on to consumers.

3 And in that case, should we be looking at the
4 transaction in terms of efficiencies? Or should we be
5 trying to assess more, in some sense, when the competitive
6 effects model doesn't apply as we have thought about it in
7 terms of coordinated interaction or unilateral effects?

8 COMMISSIONER STAREK: Kevin, speak up.

9 MR. O'CONNOR: Let me respond to that first with a
10 general comment. And I think the thing that drives both the
11 NAAG guidelines and the federal guidelines is a question of
12 who has the information about efficiencies.

13 And when you first hear about a proposed merger
14 and you read the Wall Street Journal or the paper, I mean,
15 everyone has an intuitive sense of what markets may be
16 involved, what products may be involved, and so forth. You
17 may not have the detailed information yet, but everyone has
18 it.

19 You don't know about efficiencies simply because
20 that information is internal to the firm. It's also often
21 regarded, essentially, as our experience has been, as a
22 trade secret and kept close to the vest. And so
23 consequently, that is not something you're going to learn at
24 the outset or even have an intuitive understanding of when
25 the merger is first announced.

1 Now, having said that, that doesn't answer the
2 issue; but that simply poses the problem, that is, that you
3 don't have that information up front oftentimes; and so
4 you're starting off, in your analysis, looking at the things
5 that you can measure, that is the market definition, the
6 potential competitive effects that aren't related to
7 efficiencies and so forth.

8 You may eventually get some information concerning
9 efficiencies. But presumably -- and that's one of the
10 reasons why the NAAG guidelines call upon the merging
11 parties to produce the information regarding efficiencies
12 and puts the burden on them, at least at the stage where
13 discretion is being exercised by the agency.

14 Now -- and I believe that that -- if you look at
15 the federal guidelines as well, efficiencies are sort of off
16 to the back of the guidelines in Section 4, I believe is;
17 and I think there's a reason for that. I think it's
18 implicit that that information is going to be difficult to
19 obtain.

20 Now, let me respond to your hypothetical about the
21 70 percent with the two small rivals merging.

22 I think it would be appropriate, in those cases,
23 if the parties can produce some evidence that shows that the
24 two merging firms, the small firms, are going to be able to
25 lower their prices and become more competitive with the

1 dominant firm and somehow become more of a thorn in the
2 dominant firm's side, you know, obviously, it's going to be
3 a very fact-specific test, however.

4 And I think it would be appropriate to put the
5 burden on them to show that they can come in with a lower
6 price. I mean, I wouldn't rule out efficiencies at the
7 competitive effects stage of the analysis. But I think it
8 would have to be fairly compelling evidence that it is, in
9 fact, going to induce more competitive rivalry among the
10 remaining firms.

11 MR. CALVANI: I don't think that's Ms. DeSanti's
12 hypothetical. As I understood the hypothetical, as
13 re-posed, it was that there's no assumption that the two
14 smaller inefficient firms that merge ultimately produce a
15 reduction in prices.

16 MS. DeSANTI: Let me just attempt to clarify.
17 This is the problem with trying to restate someone's
18 testimony, and I'll let you restate it any way that's
19 accurate to what your original hypothetical was, Terry.

20 I think it's my perception that your testimony was
21 that you could say that, you know, regardless of whether
22 firms could come in, as Kevin suggests, and have some
23 stories about how they would be able to reduce price and
24 become more effective competitors that there would be no
25 reduction in competition because there isn't a very

1 competitive market to begin with.

2 MR. CALVANI: Well, that brings me to answer the
3 question that I thought you asked. And -- let me make two
4 points, if I might.

5 I think there are two different kinds of questions
6 on the table. The question that Commissioner Starek asked
7 at the very beginning might present a situation where we're
8 talking about apples and oranges.

9 I find myself in agreement both with Professor
10 Muris and Mr. Arquit and agreeing with Mr. Muris --
11 Professor Muris on the way that ones goes about making the
12 legal analysis. That is, a prima facie case before you get
13 to the defense.

14 On the other hand, I think what Mr. Arquit was
15 suggesting is that, as a practical matter, the way that the
16 staff -- and for that matter -- private parties ought to
17 analyze mergers when they're first presented to them is to
18 say: Why do the parties want to merge? And that that may
19 be a useful technique of beginning one's analysis.

20 I know that -- since coming to private practice,
21 that's very often the very question I ask my clients, even
22 though I fully recognize that, in terms of steps one takes
23 doing a legal analysis for a brief, that would probably not
24 be the first question that one would present.

25 With reference to your question as to whether

1 there is a diminution in competition or an efficiencies
2 defense in the first hypothetical, I'm not sure that it
3 frankly matters a whole lot the way one approaches it.

4 In my own view, Section 7 talks about a reduction
5 in competition. And if there is no competition to reduce, I
6 don't know how you can be faithful to the statute and claim
7 a prima facie violation of Section 7.

8 So I would not find there to be a problem in the
9 first instance.

10 Nonetheless, the last time the Commission -- the
11 last time of which I am aware that the Commission addressed
12 that it reached a different conclusion. And if that were
13 the way that one chose to proceed, then at least in that
14 event I would say that the efficiencies defense ought
15 justify that transaction.

16 One last word, and I will be quiet.

17 I find myself a bit like Alice waking up in
18 Wonderland this afternoon because curiously, I find myself
19 in substantial agreement with Kevin O'Connor's
20 characterization of Merger Guidelines. The way that he
21 believes that Merger Guidelines read today and the way I
22 would like them to read are strikingly similar.

23 And so I'm willing to confess error this afternoon
24 and say that he's right and to cite these hearings in the
25 future for that proposition.

1 At the same time, I find myself curiously
2 disagreeing with Professor Muris on the relevance of the
3 redistributive consequences of antitrust. I fully agree
4 that the Williamson trade-off is one that's more interesting
5 in the academy than it's ever been in this room or in
6 private practice.

7 However, it becomes important because so many
8 people embrace redistributive policies as a rationale for
9 posing efficiencies. We've seen that here this afternoon.
10 And I think that makes the redistributive goals important if
11 for that reason and no other.

12 MR. BRODLEY: Could I reply to your question,
13 Mr. Commissioner?

14 COMMISSIONER STAREK: Please.

15 MR. BRODLEY: I think it's helpful to contrast the
16 Sherman Act and the Clayton Act.

17 In the Sherman Act, it's clear that the
18 efficiencies analysis is a part of liability and the two go
19 together, and sometimes it's more feasible even to start
20 with efficiencies if that issue is simpler than the
21 anti-competitive effects.

22 But anyway, they are blended into a single
23 judgment. But that's because -- that works, I think,
24 because you're dealing with real effects. But in the case
25 of the Clayton Act, you're dealing with incipient

1 anti-competitive risk; and it's been pointed out, there
2 isn't any necessary effect at all, simply a feared future
3 effect.

4 Then it would, I think, hopelessly complicate the
5 analysis if, at the same time, you apply into that beginning
6 analysis whether the feedback of efficiency. It's much
7 better to see if there is first such a probable future
8 effect, based usually mostly on structural factors. And
9 then say, yes, but is it overcome by the efficiency
10 potential in the transaction? And separating, it seems to
11 me, helps to make that clearer.

12 As to the hypothetical of moving from four to
13 three firms, no effect on competition or efficiencies, I'm
14 not so sure that that is innocuous. It's true that the
15 small firms are small, but you'd move the centers of
16 decisionmaking from four to three. You've made a -- in game
17 terms, you've made it a much simpler game for the parties to
18 coordinate activities.

19 So if there are no benefits, you know, I'd want to
20 look at that pretty closely before saying it doesn't present
21 a problem.

22 MR. MURIS: If I could say one thing, I agree with
23 Commissioner Calvani's reformulation of the legal issues
24 versus the, you know, sort of sitting around and trying the
25 -- and the strategic issues. That's a good way to put it.

1 And part of what happens is, in the face of
2 uncertainty -- well, let me back up. As a logical matter,
3 anti-competitive effects, in terms of looking at unilateral
4 or possible collusion or whatever, that is a separate issue,
5 from an efficiency defense; but obviously, in a world of
6 uncertainty, if you have a good story about why the parties
7 merge, I think that, inevitably you know, given uncertainty
8 about the competitive effects, that inevitably may weigh on
9 your mind.

10 So I mean, I think in an investigative stage, if
11 that's what Kevin Arquit was talking, that makes -- you
12 know, that makes some sense. Since I didn't hear him, I'm
13 not sure what he was talking about.

14 MR. O'CONNOR: I would like to comment on that
15 point as well.

16 COMMISSIONER STAREK: Sure.

17 MR. O'CONNOR: I guess when you look at the
18 reasons for merger, that's something that can be manipulated
19 to some extent and at least the stated reasons for the
20 merger. And I guess I'd be somewhat cautious about that
21 simply because -- for the same reasons that Posner's
22 cautious about attributing motive to predatory pricing.

23 I mean, it's very difficult to subscribe a motive,
24 where you look at intent in these kinds of transactions. I
25 think to the extent that there's documentary evidence of the

1 rationale for the transaction that is objective and
2 pre-exists the actual decision to merge, I think that may be
3 somewhat probative of the reality.

4 But again, intent evidence is sometimes a slippery
5 slope. And I think that that's where this suggests we ought
6 to be going.

7 COMMISSIONER STAREK: Thank you.

8 COMMISSIONER STEIGER: Kevin, first of all, thank
9 you for being here. You have been a great supporter of the
10 Chairman's effort here from day one, including helping at
11 the steering committee to frame these various questions.

12 MR. O'CONNOR: Thank you.

13 COMMISSIONER STEIGER: Let me suggest that you
14 pose a rather stark contrast in the treatment of
15 efficiencies. To paraphrase, although not completely clear,
16 federal policy appears to suggest that efficiencies are
17 considered in all cases -- I'm making this very stark -- as
18 compared to NAAG merger guides, which indicate that
19 efficiencies will only be considered where clear and
20 convincing evidence exists, that a showing of significant
21 efficiencies can't be merely predicted; therefore, would
22 constitute a defense.

23 Let's look at efficiencies a different way. For
24 merger enforcement, in general, if the contrasts are as
25 stark as I am suggesting the interpretation of efficiencies,

1 what is the impact on antitrust enforcement nationwide here?

2 MR. O'CONNOR: I'm sorry. I'm not sure I
3 understand the last part of your question.

4 COMMISSIONER STEIGER: First of all, would you
5 agree that you have drawn a rather stark contrast between
6 NAAG treatment of efficiencies and your perception of the
7 federal agencies' treatment?

8 And, if so, what does this say for antitrust
9 enforcement in general on a nationwide basis?

10 MR. O'CONNOR: Okay. Actually, I don't believe
11 that the difference is all that stark. I think that --

12 COMMISSIONER STEIGER: I was pushing you to answer
13 that.

14 MR. O'CONNOR: Okay. First of all, the clear and
15 convincing language was drawn, originally, in our original
16 draft -- in our original guidelines passed and adopted in
17 the mid '80s from the DOJ guidelines of 1982.

18 And there are commentators, including Richard
19 Schmalensee and others who think that it was a mistake for
20 the federal government to abandon that language and the
21 burden language. And because -- for the reasons I said in
22 my opening remarks -- that it's the merging parties who have
23 the information on efficiencies. And typically, courts
24 assign burdens based on that kind of a factor.

25 Okay. So that's number one. I don't believe our

1 position is all that stark.

2 And if I might, I would like to, you know,
3 contrast our position with that of Professor -- from what I
4 understood Professor Brodley to be suggesting earlier, that
5 he, at least with regard to production efficiencies, would
6 not, in a sense, permit -- or not consider an argument for
7 efficiencies where the HHI was 1800 or the single firm ratio
8 was 35 percent.

9 I know those numbers are -- I mean, he's not -- I
10 don't want to bind him to those numbers or to anything of
11 that sort.

12 But what we're talking about in our guidelines are
13 mergers in excess of those, that where we did leave the door
14 open to an efficiency showing, we did leave the door open a
15 bit. We did express skepticism, however, that given the
16 theoretical work that's been done on oligopolies and so
17 forth, that a showing by clear and convincing evidence of
18 efficiencies in excess of the likely anti-competitive effect
19 would be possible, that that's going to be difficult to do;
20 and our guidelines express that.

21 Now, having said all that, I don't think that's a
22 fairly -- an extreme policy at all or even -- I think what
23 our guidelines do is send a clear signal about how we're
24 going to treat efficiencies.

25 Last point, if you look at cases like the Morton

1 Hospital case that I cited in my testimony and other cases
2 where the states have worked with the federal agencies on
3 merger enforcement, I think the actual practice of the
4 federal government agencies and the states has been very
5 close, notwithstanding the language differences in the
6 guidelines.

7 And I think that the results -- I think that there
8 is a general reluctance to consider the first story that's
9 offered when the parties come in and say this transaction
10 ought to be approved because, in the case of two hospitals
11 in Wisconsin, they're going to merge their laundry
12 facilities. I mean, we tend to view that kind of story with
13 skepticism.

14 Now, that does not mean that our guidelines rule
15 out the possibility that parties will come and be able to
16 show substantial cost savings, especially in a declining
17 market like in north central Pennsylvania or in many health
18 care markets where the demand is simply going down, that
19 they will not be able to make a showing that this merger
20 would be in the public interest, in effect, if it was
21 permitted to go through.

22 So I don't think our guidelines are all that
23 starkly different from the federal guidelines in practice.

24 MR. BRODLEY: If I can just reply to one thing?

25 COMMISSIONER STAREK: Sure.

1 MR. BRODLEY: Just for the record, I would not
2 apply that criteria of 1800 HHI and 35 percent to a joint
3 venture. I think it should be higher for a joint venture.

4 And I would not apply it to an innovation merger
5 where it might very well be higher.

6 COMMISSIONER STAREK: Tim?

7 MR. MURIS: I want to make one practical point
8 based on my experience.

9 I think there's a fear -- usually more implicit
10 than explicit, but occasionally made explicit -- that if we
11 really allowed an efficiencies defense that didn't throw all
12 these obstacles at it, we would be deluged with
13 efficiencies. "We" being the government.

14 Well, my -- you know, I was Bureau Director for
15 almost three years. I had written an article, which at the
16 time, was the most far out, if you want to put it that way,
17 support of an efficiency defense. And maybe this is a
18 comment on the sloth of the bar, but very few people came in
19 making efficiency pitches to me. Very few.

20 COMMISSIONER STAREK: That's our experience on it
21 as well.

22 MR. MURIS: Yeah. And I'm saying when it was well
23 known -- or should have been -- that I was enthusiastic
24 about efficiencies defenses or willing to look at them,
25 there were very few.

1 And we had roughly 10 mergers a year that were
2 challenged or abandoned; and I can only think of two in
3 almost three years that would have been challenged otherwise
4 that were not challenged because of an efficiency defense.
5 And there was a third that there was some argument about.

6 So I think that fear is there, and I think it's
7 not justified. I mean, I don't think that there will be
8 reams of documents or specious claims.

9 I mean, to the extent that people come in, which
10 they frequently do, and they say there's some kind of
11 efficiency, if they can't back it up, then they lose, I
12 mean, on that issue. It's pretty straight forward.

13 MR. O'CONNOR: Can I ask a question?

14 So, I mean, you would agree that the burden ought
15 to be on the merging parties?

16 MR. MURIS: Well, the burden, if you go back to
17 Wigmore and the great evidentiary treatises, the burden --
18 the burden --there are two burdens. There is the burden of
19 producing evidence and the burden of persuasion.

20 Clearly the burden of producing evidence ought to
21 be on the parties that have the evidence, and that's the
22 merging parties.

23 I don't object to the idea of, in the legal
24 setting, the issue we were talking about before, that the
25 burden of persuasion ought to be on the -- you know, ought

1 to be on the party making the defense. I would not, in
2 terms of these subsidiary issues, like, pass on and all of
3 that, I wouldn't add those additional burdens to the merging
4 parties.

5 MR. BRODLEY: Could I ask a question as well?

6 I'm wondering if the lack of efficiency claims is
7 due to perceptions that they wouldn't be received
8 hospitably?

9 I can think of, for instance, statements that, for
10 instance, Tom Kauper has made about the efficiency claims
11 and others. I believe that Baxter has made some statements
12 which were not very hospitable.

13 So despite your own writings, you know, it's work,
14 it's time to do one of these things. And if you don't think
15 it's going to work, wouldn't that be --

16 MR. MURIS: Well, I agree that -- that would have
17 been true -- Bill Baxter was at the Antitrust Division for
18 part of the time when I was here. Maybe that was true of
19 the Antitrust Division.

20 But, you know, if you had a merger at the FTC for
21 those two and a half, three years, I was receptive. I mean,
22 everything I said before and during the time indicated I was
23 going to be receptive. So I don't think there was any
24 reason to believe there was an inhospitable atmosphere.
25 And, yet, we just were not deluged.

1 And, again, maybe it's a comment on what you're
2 saying, that -- you know, that they're hard to do. But I
3 think, you know, it's a non-trivial number of merger cases
4 that would be influenced. But I don't think it would
5 radically alter merger law.

6 MR. O'CONNOR: Well, could that be because most
7 mergers aren't challenged because --

8 MR. MURIS: No. I'm talking about the ones that
9 --

10 MR. O'CONNOR: -- the ones above the 1800 --

11 MR. MURIS: -- of the -- yeah, of the 10 or so a
12 year, where we said we'd challenge. And I can't remember
13 how many second requests we're dealing with. 30. 25. 40.
14 I just can't remember the number.

15 But we're talking about a very small number of
16 people who came in with efficiency defenses. And I only can
17 remember -- there were a lot more people that came in with
18 efficiencies defense than two. But I'm saying in only two
19 cases was the efficiencies defense decisive. One of them, I
20 think, being GM/Toyota.

21 MR. O'CONNOR: Perhaps they concluded they
22 couldn't make the showing.

23 MR. MURIS: Well, sure. No, I'm saying that's --
24 I'm saying that's possible. Sure.

25 But I'm saying the fear which exists among -- I

1 heard it expressed many times by people at the agencies,
2 that they're just going to be deluged with this evidence
3 that's going to be hard to sort through.

4 I mean, my experience, it just did not -- it was
5 not borne out.

6 COMMISSIONER STEIGER: You mentioned GM/Toyota,
7 which all of us had the enjoyable task of reviewing, as a
8 matter of fact, in lifting all provisions of the consent
9 order somewhat ahead of the end of the consent order.

10 In mentioning it, you cited areas of efficiency
11 that, I take it, Tim, you believe are not taken account of
12 frequently enough of, one being managerial skill or
13 abilities and the other, promotional efficiencies.

14 And I wondered if you could expand on that a
15 little bit and why you think it is that those particular
16 types of efficiencies are ignored by the agencies?

17 MS. VALENTINE: Actually, could we maybe expand
18 that question? You know, I think it was one of the ones
19 that we left off with at the end of this session of what
20 types of efficiencies should we care about?

21 And Terry Calvani, I think, said he felt as if he
22 had woken up in Wonderland because he may be disagreeing
23 with you in terms of what efficiencies one should recognize.

24 And I would be interested in hearing from each of
25 the four participants whether there are production and

1 innovation efficiencies that we should value more or
2 recognize more, whether anything that would cause price to
3 go down, including tax savings should be recognized, how you
4 would deal with that.

5 MR. MURIS: Well, I would accept -- I mean, I
6 don't think my views have changed significantly since the
7 article I've written. But to summarize, I would accept the
8 pecuniary, non-pecuniary distinction.

9 And on the question of management, one of the
10 reasons I'm troubled by trying to say we won't recognize
11 managerial efficiencies is, it causes the government to do
12 what it did in ADM, which is take a set of efficiencies that
13 could be characterized in several ways and dismiss them as
14 managerial efficiencies.

15 What happened there is, whatever ADM had led to a
16 lower per unit cost. Now, you could try to put that in a
17 bag of saying it was productive; you could try to put that
18 in a bag -- of a box of saying it was management; and the
19 government tried one, and the defendants tried the other.

20 In GM/Toyota, the Japanese, for a whole variety of
21 reasons had tremendous cost advantages. Part of it was the
22 management techniques that they developed. But those
23 management techniques came down to, in many cases, specific
24 things, specific differences in work rules, the so-called --
25 you know, their inventory practices.

1 I would rather look at people saying -- firms
2 coming in and saying: We think we can lower costs, and
3 here's why. And it's obviously the most credible when they
4 can show, you know, something else, their own plants, and
5 not get into the debate of trying to call it managerial or
6 something else.

7 That's what I'm talking about.

8 In fact, there are lots of situations. I do a lot
9 of consumer goods industry is what I've probably done the
10 most of over the years. I've written about a variety of
11 industries and studied them both academically and as a
12 consultant. And in a lot of those industries, for whatever
13 reasons, some firms are better than others.

14 You know, for a long time organization -- you
15 know, the Dallas Cowboys organization has been very good for
16 a long time. Harvard Law School has been good for a long
17 time. I mean, there are certain organizations, for reasons
18 that are very hard to characterize, seem to have advantages
19 over other organizations for a long period of time.

20 And what we call that -- I'm less interested in
21 what we call that than in being able to show that those
22 advantages exist and they can be transferred in some way.

23 COMMISSIONER STAREK: Others?

24 MR. BRODLEY: I'll start.

25 I would recognize scale economies, transactional

1 economies, informational economies, innovation economies. I
2 would not recognize pecuniary economies. And I'm inclined
3 not to recognize capital-raising economies.

4 I've been persuaded there by the findings of
5 Scherer and Ross that capital markets sometimes discriminate
6 against small firms for reasons that don't reflect on lower
7 costs of dealing with such firms. So I would be less
8 inclined to recognize that.

9 That also might meld over into actual pecuniary
10 economy and the ability of a large firm to simply use its
11 buying power.

12 So -- as to promotional, I didn't actually put
13 anything in the paper on that because I'm not sure I have a
14 definite answer.

15 I think what I'd say on promotional is that, I
16 wouldn't rule it out; but I'd want the agency to look at the
17 nature of the economy. And perhaps it might be there, but
18 it might not produce the social gains, say, as compared with
19 an innovation economy, which tends to compound, through
20 industries and through the economy generally.

21 COMMISSIONER STEIGER: Professor, may I interrupt
22 and ask you how you would define "promotional"? Are you
23 referring only to marketing? Or would you add product
24 distribution, product service? How narrowly would you be --

25 MR. BRODLEY: I was thinking in terms of promotion

1 and advertising.

2 When you get to things like distribution, it seems
3 to me that is an economy of -- is a production economy. So
4 there would be no problem there.

5 The question is whether things which are purely,
6 say -- advertising promotional, whether they should be
7 treated on a parity with others.

8 I guess, as I talk out loud, I wouldn't disregard
9 them. But whether they should be treated -- I guess the
10 standard would be how much -- what's their net effect on
11 social wealth? And some economies have a bigger effect than
12 others. And I think that that ought to be recognized.

13 I guess I agree with -- I think, with Tim Muris on
14 the -- for instance, the managerial. I mean, GM doesn't --
15 the label isn't too significant.

16 I saw GM/Toyota's economies as innovational
17 primarily, in the sense that it was innovational to be able
18 to take Japanese productive methods and make them work here
19 with our workers and -- who had never -- you know, in a --
20 and with a union operating and so forth. That was a true
21 innovation.

22 Of course, the claim was, you know, in the case,
23 was beyond that, which is that this innovation would
24 actually capture the other -- and be effective in the other
25 GM plants as well. And that, of course, is something that

1 one could test on ex post basis.

2 MR. CALVANI: I think the discussion this
3 afternoon where we have characterized the efficiencies that
4 would flow from a General Motors/Toyota joint venture, in
5 various and sundry ways, goes a long way toward
6 demonstrating the poverty of this kind of debate. You can
7 characterize efficiencies in lots of different ways.

8 Most of the commentary, at least prior to these
9 hearings, on segregating the various efficiencies has had to
10 do with the difficulty of demonstrating them to the
11 satisfaction of any reviewing party. And I think that's a
12 perfectly appropriate point to make.

13 But that only says that some are harder to prove
14 than others; and, where it's hard to prove, the person
15 that's going to have to prove it has a tougher task. And
16 I'm comfortable with that.

17 I guess at the bottom line, in this area, I don't
18 find myself in disagreement with Professor Muris. Where I
19 disagreed with Professor Muris earlier was on his reluctance
20 to want to talk about the redistributive consequences.

21 MR. O'CONNOR: I find myself almost agreeing with
22 everybody.

23 MR. CALVANI: Then obviously I'm on the wrong
24 side.

25 MR. O'CONNOR: Yeah, right. Oh, come on now.

1 Come on.

2 No, I think it comes down -- I particularly agree
3 with Terry on his characterization of the problem as being
4 one essentially of proof. And when you're looking at the
5 hard core efficiencies of economies of scale, integration,
6 product facilities, transportation economies, that sort of
7 thing, you generally have some hard numbers to look at. You
8 can actually put your finger on it.

9 I think the federal guidelines got it just about
10 right with the other types of efficiencies; and I'll quote
11 right here from Section 4: "The agency may also consider
12 claimed efficiencies developing from reductions in general
13 selling, administrative, and overhead expenses or that
14 otherwise do not relate to specific manufacturing,
15 servicing, or distribution operations of the merging firms,
16 although, as a practical matter, these types of efficiencies
17 may be difficult to demonstrate.

18 I think going in the direction of what it is they
19 can prove is an important one. But I would tend to leave
20 the door open for -- if you're talking about the case with
21 the HHI in the stratosphere and you're looking at the
22 efficiencies as tie breaker, I think you tend -- why not
23 open the door to a full-blown discussion of all the
24 potential efficiencies and evaluate them no matter what --
25 you know, whatever box they might happen to fit in.

1 Although I think there are some, such as pecuniary
2 and other types of efficiencies, that probably would not be
3 given great weight by anyone who is looking at it
4 objectively.

5 MR. ROBERTS: If I might, there's a little bit of
6 tension in the descriptions here -- or that I sense or feel
7 in that, on the one hand, for instance, Professor Muris
8 argues or claims that during a time, for instance, when
9 there was a general perception that the agency or that the
10 FTC might be more hospitable to efficiency claims, it had
11 very little impact on the number of efficiency claims and
12 the types of efficiency claims made.

13 At the same time, there's a lot of pleading that
14 we've heard from people that we ought to consider different
15 kinds of efficiency claims or be clearer about identifying
16 the types of efficiency claims that we will consider and how
17 we we'll consider them.

18 The question I have for the speakers -- and I'll
19 address it to Professor Muris, although I hope that you'll
20 all answer it -- and that is whether or not you think that
21 it would be useful for us to develop more -- as I think you
22 suggested earlier, some kind of more specific guidelines in
23 terms of how we are going to do efficiency analysis and what
24 exactly we are going to consider and whether or not you
25 think that currently, what some perceive as a failure to

1 have done so has influenced the nature and type of
2 efficiency claims that are made for it.

3 MR. MURIS: Well, I mean as an academic, I have
4 never accepted the view, which a lot of attorneys who have
5 been at the FTC have had, which is: We don't want to tie
6 our hands. You know, we want to be able to have discretion.
7 And, therefore, we don't want to -- you know, the less we
8 tell people the better about how we make decisions.

9 I mean, as an academic, I've always thought the
10 opposite: The more we tell people about how we make
11 decisions, the better.

12 And if that means -- and I think in this case it
13 does -- trying to clarify some of these questions about
14 efficiencies, I think that would be ultimately good. And,
15 obviously, you have a limited number of staff resources and
16 you can't try to clarify everything.

17 But I think this question is important enough, it
18 comes up in enough areas -- hospital mergers probably being
19 the most prominent one right now -- that the Commission
20 ought to go ahead and take a stab at addressing the issues.

21 I don't think it will have -- I mean, at the
22 margin, as economists like to say, I think it will have a
23 difference. But we're not talking about, you know, a major
24 difference. You know, if it's a couple of cases a year or
25 something where you really have to delve into this -- I

1 don't think that's a sea change.

2 COMMISSIONER STAREK: Other responses to
3 Dr. Roberts's question?

4 MR. CALVANI: I think it's a good idea.

5 On the other hand, I think the changes that you
6 have made in prior approval and not filing administrative
7 actions as a regular matter of course, dwarfs -- immensely
8 dwarfs this issue in terms of its overall importance.

9 COMMISSIONER STEIGER: Can I respond?

10 COMMISSIONER STAREK: Sure.

11 COMMISSIONER STEIGER: I think all of us who have
12 worked through this period of time very much appreciate,
13 Terry, your favorable comments on our attempts at internal
14 efficiency, if you will, in the areas of sunset, Part III,
15 and prior approval. They were extremely well researched and
16 studied issues, and a great amount of resources were devoted
17 to them.

18 Would you care to add any further suggestions,
19 while we're on this subject of efficiency? You were one of
20 our most distinguished alums here as a Commissioner.

21 What else is it that we should do to internally
22 become more efficient in the process?

23 MR. CALVANI: Well, thank you for the invitation.
24 I will respond in writing after I have had a chance to --

25 COMMISSIONER STEIGER: I knew I could depend on

1 that.

2 MR. CALVANI: -- to collect my thoughts on that
3 subject.

4 I really do think the changes in sunseting -- but
5 more important the changes in prior approval and the changes
6 in the administrative process are, in my mind, the most
7 significant developments in merger law practice in 15 years,
8 bar none.

9 It is -- as someone returning to private practice,
10 it was incredibly important to me to -- ceteris paribus,
11 which is never the case, but assuming all other things being
12 equal, to secure review by the Antitrust Division. The
13 asymmetry in the costs of review between the two agencies
14 was such that you just simply could not afford to litigate
15 against the Commission. Because the day that you darkened
16 the door of the federal courthouse, you confronted an
17 administrative action. And the only way of getting rid of
18 an administrative action was to sign a prior approval
19 provision.

20 And as much as we said, representing private
21 parties, that we would litigate until hell froze over and
22 see you on the steps of the United States Supreme Court,
23 nobody believed that because it wasn't true. Very few
24 companies had the stomach or, perhaps better, the resources
25 to endure six, eight years of administrative litigation.

1 So the changes that the Commission has made in
2 this area are exceedingly important, and I would just simply
3 urge that you give more thought to these same subjects.

4 It remains to be seen, frankly, exactly how those
5 two will shake down. The announcements, as I read them from
6 the agency, do not indicate that the agency will not file
7 administrative actions. It simply says that we won't always
8 file administrative actions, or routinely file
9 administrative actions in a certain setting; and we won't
10 always insist on prior approval provisions. And it will be
11 interesting to see how all that shakes down.

12 I also think it's not a bad idea to revisit the
13 issue periodically of how long orders ought to remain before
14 they do sunset.

15 I'd just simply commend to you on what it is that
16 you have done to date. I think they are very important, and
17 they are the most important changes in the agency in a very
18 long time to render at least Section 7 enforcement more
19 efficient.

20 MR. O'CONNOR: I would like to go back to
21 Mr. Roberts' question about how much detail you want to put
22 in policy statements about what efficiencies to consider, if
23 I could?

24 COMMISSIONER STAREK: Sure.

25 MR. O'CONNOR: I am of the belief that a good

1 prosecutor, for lack of a better word, or a government
2 enforcer, ought to consider all the factors that go into a
3 particular transaction.

4 And, again, remembering that we are only talking
5 about here, apparently, the transactions that are going to
6 cause anti-competitive concerns. And that -- the question
7 then becomes: Should, as a policy matter, we make a laundry
8 list of every conceivable efficiency that we might consider?

9 My concern with that approach is informed not just
10 by merger enforcement but by general practice as a
11 government attorney doing criminal cases, the securities
12 fraud area, and other areas is that, when you put that kind
13 of statement out there, that you're going to consider all
14 these factors, judges have a way of reading those standards
15 and saying, but Mr. O'Connor, you didn't talk about these
16 six factors when you were doing this case; you don't point
17 out this; you didn't do that.

18 As you know, the federal government has had its
19 problems with its Merger Guidelines in cases such as Baker
20 Hughes where the Guidelines are cited back as part of the
21 rationale for the decision in those cases.

22 And so I would --

23 COMMISSIONER STAREK: That's why they were
24 changed.

25 MR. O'CONNOR: Pardon?

1 COMMISSIONER STAREK: That's why they were
2 changed.

3 MR. O'CONNOR: Yeah.

4 I guess -- so, where I'm going with this is, as
5 long -- I don't have a problem with guidelines if there is a
6 laundry list of that sort as long as burdens are assigned.

7 And see, I guess as long as it's clear in the
8 guidelines themselves that the burden in this area, where
9 the information is in the possession of the merging parties,
10 is on the merging parties to bring in the evidence showing
11 that there's actual efficiencies there.

12 Then, I guess I'm less concerned about it than a
13 documents that simply says: These are the factors we're
14 going to consider. But we're not going to talk about
15 burdens.

16 MR. BRODLEY: Could I speak to the question, too?

17 COMMISSIONER STAREK: Sure.

18 MR. BRODLEY: I think it would be desirable, at
19 some stage, to have guidelines as to efficiencies. But the
20 question, I suppose, is when you feel that you have the
21 experience to make those meaningful and buttressed by the
22 consideration that Kevin gave as well?

23 In other words, it may be that those are better
24 done after you've had some experience in evaluating them,
25 particularly if you adopt a new procedure for evaluating

1 efficiencies so that you get more of these cases and that
2 perhaps informal advice could be given; but in terms of
3 getting it into guidelines, it might -- you know, I'd just
4 raise the question: Would it be better to wait until
5 there's more experience?

6 COMMISSIONER STEIGER: Professor, thank you for
7 that observation. Those of us who struggled hard in two
8 sets of health care enforcement policy efforts came to the
9 conclusion that the only areas in which we could offer a
10 safety zone statement were those in which we had experience
11 sufficient to give us a very high degree of confidence that,
12 absent some extraordinary circumstance, an anti-competitive
13 effect was not likely.

14 We were all careful to say this does not mean that
15 conduct outside of the safety zone is suspect, simply that
16 we do not know enough to guarantee for ourselves that it
17 will not result in an anti-competitive effect.

18 COMMISSIONER STAREK: Comments?

19 MR. MURIS: Well, one thing that troubles me with
20 merger law in the last 10, 15 years, it's become an
21 increasingly highly specialized form of regulatory law,
22 dominated -- well, "dominated" is too strong -- but where a
23 few law firms have a -- do a large bulk of the second
24 requests and have an advantage -- and I think it's incumbent
25 upon the Commission to try to release -- and the Justice

1 Department -- and they've done a lot of this; and I think
2 they ought to be commended for that -- to try to release as
3 much information as possible about what it is that they're
4 doing.

5 One of the things that wasn't done by the
6 government that came out of government data is the paper
7 that Fred McChesney and a few other people did a few years
8 ago where it was controversial here; but they took
9 Commission challenges for a four or five year period of time
10 and looked at, to what extent the guideline factors
11 influenced various cases and did some statistical work on
12 it.

13 You don't have to go that far. But, I mean, I
14 don't think it would hurt at all for the Commission -- and
15 there has been more of an effort to do this in the Division
16 -- to talk about its experience, without violating
17 confidentiality, with its merger investigations.

18 And the more steps that can be taken in that
19 direction, the better. And, obviously, a statement about
20 how they apply efficiencies, I think, would be very helpful.

21 COMMISSIONER STAREK: Thank you.

22 In addition to Dr. Roberts from our staff, we also
23 have with us today Laura Wilkinson, who is the Deputy
24 Director of one of our merger shops here in the Bureau of
25 Competition. And since she was trained in this Commission

1 by Steve Newborn, among others, I'm sure she's not shy and
2 probably has a line of excellent questions.

3 Laura?

4 MS. WILKINSON: I just have one question, and it
5 is from my practical perspective.

6 I've enjoyed the policy discussion that we've had
7 today; but practically, how can we actually implement these
8 policies?

9 And I would like to hear from the panelists, is it
10 realistic that companies will be able to provide evidence of
11 these efficiencies that will allow us to evaluate the
12 efficiency arguments that they offer?

13 I have heard Professor Brodley talk about,
14 perhaps, industry studies and things like that; but they
15 don't seem to be merger-specific. And, in fact, in many
16 industries, there are no such studies.

17 So, what kinds of evidence would you suggest that
18 companies bring in? And would they be able to actually
19 bring in evidence?

20 MR. BRODLEY: Well, I gave a list of evidence that
21 I thought would be appropriate; but that doesn't mean that,
22 if they don't bring their evidence in, their claims can't be
23 considered. So they bring in the best evidence that's
24 available.

25 But say at the ex ante stage, they certainly have

1 made some studies of the efficiency properties of the
2 transaction, if that's their main claim.

3 So they could, to begin with, bring in -- and
4 those studies ought to have been made before they
5 anticipated litigation. In other words, those should have
6 been in the planning stage. So I think they could bring
7 that kind of study in.

8 They can also undertake a study that's
9 firm-specific, which -- such as a -- particularly at the
10 plants level, such as an engineering study or a statistical
11 cost study.

12 The survivor test studies are ones that -- where
13 the data should be available in terms of the growth of the
14 firm relative to other firms in the industry.

15 So, it's true, your point is well taken. If
16 you're talking about inter-industry studies, they can't make
17 a -- can't be expected to make an inter-industry study. But
18 they may exist. For instance, past experience in similar
19 mergers may exist.

20 So they should -- when they bring -- I'm talking
21 about those things. They bring in the data which is already
22 available. Not -- they don't have to -- they're not
23 expected to create new data outside the firm itself.

24 And so I think -- I mean, I wanted to be
25 comprehensive and suggest all the kinds, because it's --

1 they won't have these things in all cases; but they'll be
2 available sometimes, in some cases, and some of them will be
3 available. And I think the totality could tell a good --
4 make a good representation and picture.

5 COMMISSIONER STAREK: Other thoughts?

6 MR. O'CONNOR: I would agree with Professor
7 Brodley on that.

8 MR. CALVANI: I think the question is a very hard
9 question. And the best I could do for an answer is: It
10 depends.

11 I recall when I was here at the agency, some --
12 very few, but some cases where the efficiencies were really
13 patent on the face of engineering plans. It could be laid
14 on top of one another.

15 I remember one case where it was dramatic and
16 everybody stood back and said: Gee, this is very
17 interesting. Let's look at it more.

18 I remember countless other cases where people
19 said: Well, it's smoke and mirrors, and we went on to the
20 next thing.

21 So I -- it's not always a tough job. Sometimes
22 it's easier; sometimes it's more difficult. And I think the
23 question maybe is too hard to answer other than just to say
24 it's going to depend on the circumstances of each case.

25 COMMISSION STEIGER: May I go back to Professor

1 Muris on that regard?

2 I think you mentioned that in your time here at
3 the Commission as Bureau Director, I think you said there
4 were two, maybe three, transactions that turned on
5 efficiencies or in which they were a critical element.

6 Can you tell us what particular efficiencies were
7 the most striking? Was there a market basket of them that
8 appeared in the two or three? Or did they vary all over the
9 lot? From your experience.

10 MR. MURIS: Well, it -- partly there's this
11 problem of trying to characterize efficiencies in various
12 boxes.

13 But in the cases that I'm talking about -- and
14 throw in ADM as another example that I have studied; and the
15 case was going on at the Justice Department at the time --
16 people were able to show, I think with high conviction, that
17 they had low per unit costs and that they could translate,
18 by taking over these other plants, they could translate
19 those efficiencies, whatever their source, and have lower
20 per unit costs.

21 I think a tougher kind of efficiency but which
22 I've seen in a few cases is where somebody, for whatever
23 reason, has, you know, a group of people that are better at
24 growing a market, a so-called niche market; I mean, they
25 figured out a way to prosper in the niche and have various

1 ideas; and they're trying to merge with somebody else who's
2 old and staid and has not been so innovative. That's a more
3 difficult and qualitative kind of assessment to make.

4 Again, I mean, there are lots of issues that are
5 hard. This doesn't strike me, quite frankly, as any harder
6 than product market definition, maybe because I spent a lot
7 on time on both. You know, they both can be difficult, and
8 they both can be relatively easy. But I mean, you've got to
9 -- you've got to, obviously, make the call. And there's no
10 magic, but I think smart people working at it can form a
11 reasoned judgment. Sometimes reasonable people will
12 disagree; but, you know, they can form judgments.

13 And instead of doing that, I think we spent too
14 much time saying -- you know, worrying about what would
15 happen if we actually spent time looking at efficiencies.

16 MS. DeSANTI: Let me see if I can probe farther
17 because I think that Laura's question merits more of a
18 response than she's gotten so far.

19 It's all very well for you, Commissioner Calvani,
20 now outside the agency to say: Well, it's hard sometimes,
21 sometimes it's easy.

22 But it seems to me if we're going to be responding
23 to people coming in and saying: You really need to take
24 efficiencies more into account and you've been
25 automatically, agency, taking too skeptical a view of these

1 because you're so concerned about the proof.

2 And then we ask: Well, what should we look to for
3 proof; and you say: Well, sometimes it's hard, sometimes
4 it's easy.

5 What kinds of documents, in your experience -- and
6 you've had experience in this kind of area, for most people
7 on this panel, both as government enforcers and in private
8 practice -- in your experience, what kinds of business
9 documents should the agencies be expecting companies to come
10 in and show us in order to validate efficiency claims?

11 MR. MURIS: Well, I guess -- and I don't know the
12 right way to phrase this; but if you deal with business
13 documents -- and everybody here has dealt with business
14 documents a lot -- I mean, accounting is -- take the
15 relatively easy case, the case I was talking where we were
16 talking about per unit costs. There's something that
17 businessmen worry about. They worry about -- other than in
18 the context of the merger -- I agree with Professor Brodley
19 that, obviously, documents that are prepared in a normal
20 business context are a lot more reliable.

21 The kind of rules that you apply to product market
22 definition documents, one of which I just mentioned, are the
23 kind of rules you would apply to efficiencies. I mean I
24 don't think it's substantially different.

25 There are times in a product market definition

1 where somebody is claiming, you know, something that seems
2 far-fetched, competes and should be in the market, where you
3 require -- you know, you require more evidence because it
4 seems intuitively implausible to you.

5 And I think that's the same with costs. I've seen
6 lots of industries -- I ticked off some; the beer industry
7 is another one -- where the Justice Department in the '70s
8 stopped -- changed its enforcement procedure because it
9 became convinced that there were substantial economies in
10 that industry; and it was stopping a trend that was
11 inevitable.

12 Again, that's a relatively easy case, I suppose,
13 because you are dealing with per unit costs and something
14 that's relatively quantifiable. But I don't see any reason
15 why because there are relative easy and relatively hard
16 cases; it's different than market definition.

17 MS. DeSANTI: Let me press you a little bit more
18 and just ask you about one possible reason.

19 In product market definition, we're usually
20 looking at current product market sales to answer the
21 question of what is the appropriate relevant product market.

22 Whereas, as to efficiency claims, we're looking
23 prospectively at: What are the efficiencies that will be
24 generated by combining these companies?

25 Isn't that --

1 MR. MURIS: But almost invariably an efficiency
2 claim is going to be based in the current experience of the
3 firm, at least almost all the ones that I have seen.

4 Now maybe sometime, you know, somebody makes the
5 first move to build a bigger plant; and that's relatively
6 speculative. But then they don't build the bigger plant
7 without considered judgment about what the relative costs
8 are going to be.

9 So the fact that it's prospective, in some sense,
10 I don't think makes it significantly different. Quite
11 frankly, the 5 percent test -- which I think was a wonderful
12 innovation -- is a blindfold and pin the tail on the donkey
13 in a significant number of cases.

14 In other cases -- I mean, you've got exports
15 coming in and you've got price changes, and you can do
16 econometric analysis.

17 So, again, I don't think there's anything
18 magically different. And if it turns out -- and this is the
19 key with the allocations of burdens -- if it turns out that
20 it's speculative, it's speculative. They lose.

21 MR. O'CONNOR: I guess the problem I'm having with
22 this question is that the type of documentation you want is
23 going to vary from case to case very radically.

24 If you're looking at a hospital merger case, I
25 might be very interested in seeing if Hospital A has

1 undertaken a study to see why its number of heart by-pass
2 surgeries has been going down over the previous years; and,
3 you know, what they can do about it. What is -- and then
4 they start looking at what's happening in the rest of the
5 hospitals in the area and so forth.

6 And, you know, if I saw that kind of
7 documentation, I might be persuaded that there's something
8 going on here in the market that would explain why this
9 Hospital A wants to merge with Hospital B and lower its unit
10 cost in heart by-pass surgery.

11 If you're looking at an innovation market where
12 you're talking about some sort of high-tech product that's
13 coming down the line, it might be a completely different
14 type -- I mean, they might have tried for years to develop a
15 particular kind of product; or they have the product and
16 they haven't been able to get it to the marketplace for some
17 reason; and now they're looking at a merger for some other
18 reason, and you're looking at a different kind of document
19 that may be intertwined with the competitive effects of the
20 transaction more directly than in the hospital case, where
21 -- where the -- let me just stop there.

22 I mean, I'm not sure I can generalize to -- give a
23 generalized answer to the question that's been posed here,
24 as to the category of documents? I guess, it's sort of the:
25 I know when I see it standard.

1 What you want are objective business documents
2 that explain what's actually happened in the market and why
3 they might be doing what they're doing.

4 Although, as I mentioned earlier, I'm a little --
5 I get a little concerned if a documentation that gets closer
6 to the time the merger was proposed and they're sort of
7 self-serving representations as to why they want to
8 undertake the merger.

9 MR. BRODLEY: Could I respond to that briefly?

10 COMMISSIONER STAREK: Sure.

11 MR. BRODLEY: Doesn't this illustrate the
12 advantage of a two-staged approach?

13 That is to say, at the first stage, if all you
14 have to show is you've got a plausible account that
15 efficiencies are likely to occur, then you don't have to
16 agonize in the same way as if you're making a final
17 judgment.

18 Later, you will be looking at documents that
19 actually exist as a transaction that have had an experience,
20 and then you can apply the normal methods to documents. In
21 other words, you have contemporaneous documents.

22 COMMISSIONER STAREK: Well, we certainly talked a
23 lot about the -- how difficult it is to measure efficiencies
24 and present them to enforcement authorities. What about the
25 other two points that I made at the outset?

1 Do efficiencies have to be merger-specific in
2 order to be recognized?

3 And what does "merger-specific" mean? I mean, it
4 means different things to different people; and we've heard
5 that in previous sessions on efficiencies.

6 And, secondly, do mergers have to be -- do
7 efficiencies have to be passed on to consumers? If so, do
8 they have to be passed on immediately? Or can we look at
9 diffusion and innovation markets? Can we look down the
10 line? Follow a two-step approach that Professor Brodley
11 asked?

12 Anybody want to take those on?

13 MS. VALENTINE: And can I add one little thing to
14 your "merger-specific," because I agree with you, we have
15 heard so many different formulations of that.

16 But because today we're also hearing a lot about
17 burdens and how important they are, that's one place where
18 we hear many different stories about who should have the
19 burden.

20 So assuming that one were to have some standard
21 like that, where should the burden be as well?

22 COMMISSIONER STAREK: Any takers?

23 Kevin.

24 MR. O'CONNOR: Well, assuming we're talking about
25 efficiencies showing, say, mergers that have

1 anti-competitive effects. Okay?

2 By assumption, then we have a merger that is going
3 to impose a cost on the economy by some increase in
4 allocative inefficiency, okay? as well as redistribution of
5 some sort. Okay. So you have, by assumption, that going
6 on. Now the question is: Should the merging parties be
7 required to show the efficiencies, the technical and
8 production efficiencies, are merger specific?

9 When you frame the question that way, I think the
10 answer has to be: Yes. I mean, that what you're talking
11 about is an offset of some sort to the merger-specific harm.
12 So you need some merger-specific gain in that analytical
13 sense.

14 I mean, if you're talking about a merger below the
15 threshold that you've concluded hasn't caused a problem,
16 then you don't care about the efficiencies as such. I mean,
17 it's passed the filters, so you're done.

18 So I guess that's -- now, what do you mean by
19 "merger-specific"? That gets back to a proof question.
20 And, again, because I'm the lowly government attorney
21 sitting here waiting for the parties to bring me
22 information, for the most part -- although, I can go out and
23 do some interviewing of third parties and so forth -- most
24 of this information about efficiencies is internal to the
25 merging parties. I'm waiting for them to provide me the

1 information that will allow me to make this assessment.

2 So, I mean, that's where I come on the burden
3 question. And that's one of the reasons why we were so --
4 you know, we felt very uncomfortable eliminating that part
5 of our guidelines.

6 COMMISSIONER STAREK: Any other thoughts?

7 MR. BRODLEY: I have a question, Mr. Commissioner.

8 How is "merger-specific" different from the
9 phraseology "no reasonably less restrictive alternative"?

10 COMMISSIONER STAREK: Good question.

11 MR. BRODLEY: I mean, if it's -- I would think
12 that it is the same thing; but I'm wondering if that's what
13 you mean. You don't mean anything different by that really?

14 Anyway, it's an important question; but I'm just
15 trying to get that in mind.

16 And, I mean, the question of burden, of course, is
17 difficult on that issue in the sense that it seems pretty
18 arduous to require the parties to come in and prove, as
19 against all possible transactions, this is the least
20 restrictive.

21 And I have come out with the idea that if they
22 have discharged their burden of showing that the transaction
23 is efficiency justified that it's really up to the agency --
24 well, of course, aided by discovery and so forth -- to
25 suggest what are these less restrictive alternatives that

1 exist; and then I think the parties can then meet the burden
2 of showing, well, no, Plan A is not a reasonably less
3 restrictive alternative nor is Plan B or C.

4 It seems to me that might be the way to deal with
5 the problem of burdens so that the burden then -- that the
6 agency has named things that are plausibly things within the
7 ballpark of less restrictive, then the parties could come
8 forward and show that that's not the case.

9 MR. CALVANI: I wonder whether this is a real
10 issue. I mean, I can see where you would say: Well, we're
11 not going to take account of efficiencies.

12 If it's an efficiency which you the company could
13 accomplish if you did absolutely nothing more than just
14 simply implement these changes internally, well, that sounds
15 nice. It also assumes that government reviewing agency is a
16 better manager of the company's assets than are its current
17 management. And I find that a difficult assumption to make.

18 I think people generally try to profit maximize;
19 and if there are just efficiencies that they're stumbling
20 over out there and they have chosen not to make them but the
21 government can help identify them and help them run a more
22 efficient organization, perhaps; but I'm skeptical.

23 Then there's another alternative. And that is,
24 well, let's think about other things you might do other than
25 this merger. We've been thinking about a joint venture that

1 you might do over here. And I have the same problem with
2 that.

3 I can come up with a great hypothetical if you'll
4 let me make all the assumptions I want to make that would
5 clearly, I suppose, to the satisfaction of some demonstrate
6 that we ought to require mergers to be specific. It
7 requires all kinds of assumptions that I think in real life
8 are very difficult to do.

9 So I guess I come out pretty at much the same
10 place that I understand Professor Brodley comes out on that
11 issue.

12 MR. O'CONNOR: Can I respond to that?

13 First of all, by "assumption" here -- at least the
14 assumption that I have been making is that we deal -- we get
15 to the efficiencies question only after we found that a
16 merger has some anti-competitive harm and causes some harm.
17 And that's the job of the government enforcers in this case,
18 is to deal with that issue. Clayton Act Section 7 says:
19 Thou shalt not merge if it will substantially tend to reduce
20 competition.

21 So it isn't a question of the government, you
22 know, willy-nilly going out and intervening in private
23 business decisions. For the most part, most of these
24 rationale for merger aren't even an issue in the review
25 because they're below the thresholds, there's no competitive

1 effects story, entry is easy. For any number of reasons,
2 you don't even get to this issue.

3 So, you know, I guess I take issue with the
4 characterization that when you get to the efficiencies
5 questions, it's government intervening in this private
6 decision as a matter of course.

7 So, you know, I guess I just have a problem with
8 that characterization of what's going on here, since the
9 number of mergers in which you would have this kind of
10 efficiency review is probably fairly minimal, fairly small.

11 MR. MURIS: On that question, I mean the Congress
12 clearly had prior approval statutes before it rejected them.
13 I mean, this is the -- I mean, they are allowed to merge
14 unless the government can stop them.

15 And I think Professor Brodley's characterization
16 is correct as to the allocations of burdens. I think that's
17 a good way to go on this question.

18 MR. O'CONNOR: One more point that I wanted to
19 make, going back to the hypothetical, at times I wear
20 another hat in our office; and that is representing some of
21 our state agency clients. And I remember a time long before
22 the states were ever in the merger business when our
23 university hospital came to me and said: Can we buy a
24 lithotripter with the competing hospital down the road.

25 And, you know, after looking at it and after

1 reading BMI again for the 12th time, I decided, well, you
2 can do it; just price out the services separately, you know,
3 obviously makes sense. Neither one of you can afford it
4 independently ta-dah, dah, dah and on and on and on.

5 Now if they had come to me and said: We want to
6 merge. And I would say: Why do you want to do that. We
7 want to merge with Hospital A down the road because we want
8 to buy this lithotripter.

9 I'd have a problem with that. I'd probably take
10 off my counseling hat and put on a different hat, my
11 enforcer hat, and say: I don't think that's such a good
12 idea because, obviously, you can do this in a different way
13 if that's the limited purpose for which you wanted to
14 undertake this. I think there's a way to distinguish what's
15 merger-specific and what's not in most cases.

16 COMMISSIONER STAREK: Passing on to consumers?
17 Any more comments on that? We have Professor Muris's views.

18 MR. BRODLEY: I'm sorry. I didn't hear you.

19 COMMISSIONER STAREK: Passing on to consumers.
20 How should enforcers deal with the question that -- or the
21 assertion that, for efficiencies to be considered, they need
22 to be passed on to consumers immediately?

23 MR. CALVANI: I think that brings us back to where
24 we started on the redistributive issue where I agree with
25 Professor Muris that it ought to be unimportant; but I think

1 it is important because those that would minimize the role
2 of the efficiencies defense often resort to the
3 redistributive consequences of antitrust as a justification
4 for doing so.

5 I would assume -- let's just assume for purposes
6 of argument that we all embrace some sort of social agenda
7 for antitrust, including redistributive consequences.

8 I'm willing to admit that there's probably not a
9 lot of yacht companies in highly concentrated industries
10 that are owned by blue collar pension funds. There may be
11 some, but there's probably not lots of them.

12 However, if we're going back to 1914 and we're
13 looking at the purposes of the Clayton Act and we're seeing
14 -- which I don't see -- but assume we see redistributive
15 objectives there, I suspect that if we looked at the average
16 equity -- the average earnings of Americans generally and
17 the average earnings of American equity shareholders in
18 1914, we might see some striking difference.

19 And the question that I would pose for those that
20 do embrace redistributive goals or a social agenda for
21 antitrust is: Is it not appropriate today to go back and
22 take a look at that issue and to see precisely what are the
23 well -- what are the transfer payments, the size of the
24 transfer payments and the identity of transferors and
25 transferees today, in 1995, when we have a radically

1 increased presence of pension funds in the market and
2 eleemosynary institutions and the like.

3 I'm not suggesting that it's going to flip flop.
4 But I am suggesting that the difference between 1914 and
5 difference today, if you embrace those goals to start off
6 with, is striking.

7 And I think that there is -- there ought to be an
8 injunction for those of us -- or those of you who would play
9 Robin Hood. And that is, before we get out our little green
10 tights and start putting them on and start dashing into
11 Sherwood Forest, it might be a good idea that we make
12 absolutely sure that we separate Maid Marian from the
13 Sheriff of Nottingham. Because it would be perverse, if
14 having adopted redistributive goals, we were out there
15 robbing Friar Tuck and giving to the evil Prince John.

16 And it seems to me that that's an exercise that's
17 worth undertaking for those of you -- for those of you who
18 would subscribe to that agenda. It's probably something
19 that ought be done.

20 MR. BRODLEY: I'd like -- could I respond?

21 COMMISSIONER STAREK: Sure.

22 MR. BRODLEY: I don't think we should try to be
23 Robin Hood. I agree.

24 But let me suggest that there's no escaping that
25 consumer benefit is an important objective. The question is

1 whether it's an immediate objective, and that's the issue
2 that pass on poses.

3 As long ago as 1916, Judge Learned Hand said in
4 one of his earliest antitrust cases that the consumer
5 benefit does not require an immediate pass on of benefits.

6 And I think the question is whether there is going
7 to be some ultimate pass on of the benefits of -- to
8 consumers.

9 And in my proposal, I have had two conditions on
10 an efficiencies defense designed to assure an eventual pass
11 on.

12 First, that in allowing a combination at some
13 level of the productive process that competition be retained
14 at some other level. The idea there is that having
15 competition say at a vertically related level, assures that
16 there will be pressures for competition at the restrained
17 level.

18 Second, even at the restrained level, that the --
19 that the restraint not be permanent unless it's an
20 indispensable condition, like it was in Broadcast Music.
21 But in other cases it would be limited in time, as a joint
22 venture, for instance could limit it in time.

23 So building, so far as possible, those conditions
24 ensures that eventuality of consumer benefit.

25 Further, the trade-off, I think that was -- Judge

1 Hand didn't say this, but the trade-off motivates -- the
2 temporary sacrifice of the consumer benefit are the possible
3 great welfare spillovers from some kinds of efficiencies,
4 like better productive process which would resonate through
5 other parts of the economy.

6 And I guess, finally, I would just remind people
7 of something that the Chairman put in an article in 1992;
8 but, in any event, a complete pass on isn't possible except
9 in a competitive market. And in that case, you don't have a
10 restraint so that, in a sense, you know, it's almost
11 impossible to get.

12 So for all those reasons, it seems to me that
13 immediate pass on -- I put it always that way -- that
14 immediate pass on is not required in order to benefit
15 consumers.

16 COMMISSIONER STAREK: Tim?

17 MR. MURIS: In response to something Terry said,
18 let me go back to my original point.

19 I think if we looked fairly and objectively at
20 current merger law, we realize the very tenuous basis of
21 that law from an economic standpoint.

22 The old market concentration doctrine is dead.
23 Attempts to buttress it in the modern game theory economics
24 has not gotten us very far and almost nowhere empirically.
25 Earlier drafts of the 1992 Merger Guidelines in the

1 Department of Justice made some attempts to try to bring in
2 game theory notions more than they ended up; and it was just
3 very hard to do.

4 And I think we have to realize that because the
5 current standards, in most cases, give at best a very weak
6 measure of anti-competitive conduct, that's what I think the
7 main message that I'm trying to say today is that
8 efficiencies, when they can be shown, tend to be revealed
9 with stronger evidence than the anti-competitive story that
10 comes out of the merger. And we ought to pay all the more
11 attention to them.

12 If we were really believers in the market
13 concentration doctrine, you know, as they were in the '60s
14 and early '70s, it might be a different story. But that
15 basis just does not exist any more.

16 COMMISSIONER STAREK: Well, final word?

17 MR. O'CONNOR: Can I just comment on pass on
18 briefly?

19 I agree with Professor Brodley that the timing of
20 the pass on is a critical question. But I think it
21 underscores the difficulty of making the measurement of the
22 trade-off of the technical efficiencies that are achieved by
23 the merger against the allocative inefficiency and
24 redistribution problem.

25 And, obviously, ours don't -- the NAAG guidelines

1 don't expressly give a time frame for the pass on or what
2 needs to be done; but it ultimately comes down to a very
3 case-specific analysis.

4 COMMISSIONER STAREK: Thank you.

5 Any other thoughts or comments?

6 Well, thank you. This has been truly a very
7 interesting afternoon. I actually learned a few things. I
8 appreciate it. It was very, very helpful.

9 Thank you for coming. Thank you for taking the
10 time to prepare very thoughtful statements and for taking
11 time this afternoon to share your thoughts with us.

12 (Whereupon, 4:27 p.m., the hearing was recessed.)

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1 C E R T I F I C A T E

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3 DOCKET/FILE NUMBER: P9512014 CASE TITLE: GLOBAL AND INNOVATION-BASED COMPETITION5 HEARING DATE: November 7, 1995

6

7 I HEREBY CERTIFY that the transcript contained
8 herein is a full and accurate transcript of the notes taken
9 by me at the hearing on the above cause before the FEDERAL
10 TRADE COMMISSION to the best of my knowledge and belief.

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DATED: November 7, 1995

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(NAME OF REPORTER - TYPED)

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